BANK OF AMERICA AND MERRILL LYNCH: HOW DID A PRIVATE DEAL TURN INTO A FEDERAL BAILOUT? PART V

JOINT HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT
AND GOVERNMENT REFORM

AND THE

SUBCOMMITTEE ON DOMESTIC POLICY

OF THE

COMMITTEE ON OVERSIGHT
AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

DECEMBER 11, 2009

Serial No. 111–102

Printed for the use of the Committee on Oversight and Government Reform

Available via the World Wide Web: http://www.gpoaccess.gov/congress/index.html
http://www.house.gov/reform

U.S. GOVERNMENT PRINTING OFFICE

63–135 PDF WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

EDOLPHUS TOWNS, New York, *Chairman*

PAUL E. KANJORSKI, Pennsylvania
CAROLYN B. MALONEY, New York
ELIJAH E. CUMMINGS, Maryland
DENNIS J. KUCINICH, Ohio
JOHN F. TIERNEY, Massachusetts
WM. LACY CLAY, Missouri
DIANE E. WATSON, California
STEPHEN F. LYNCH, Massachusetts
JIM COOPER, Tennessee
GERALD E. CONNOLLY, Virginia
MIKE QUIGLEY, Illinois
MARCY KAPTUR, Ohio
ELEANOR HOLMES NORTON, District of Columbia
PATRICK J. KENNEDY, Rhode Island
DANNY K. DAVIS, Illinois
CHRIS VAN HOLLEN, Maryland
HENRY CUELLAR, Texas
PAUL W. HODES, New Hampshire
CHRISTOPHER S. MURPHY, Connecticut
PETER WELCH, Vermont
BILL FOSTER, Illinois
JACKIE SPEIER, California
STEVE DRIEHAUS, Ohio
JUDY CHU, California

DARRELL E. ISSA, California
DAN BURTON, Indiana
JOHN L. MICA, Florida
MARK E. SOUDER, Indiana
JOHN J. DUNCAN, JR., Tennessee
MICHAEL R. TURNER, Ohio
LYNN A. WESTMORELAND, Georgia
PATRICK T. MCHENRY, North Carolina
BRIAN P. BILBRAY, California
JIM JORDAN, Ohio
JEFF FLAKE, Arizona
JEFF FORTENBERRY, Nebraska
JASON CHAFFETZ, Utah
AARON SCHOCK, Illinois
BLAINE LUETKEMEYER, Missouri
ANH "JOSEPH" CAO, Louisiana

RON STROMAN, *Staff Director*
MICHAEL MCCARTHY, *Deputy Staff Director*
CARLA HULTBERG, *Chief Clerk*
LARRY BRADY, *Minority Staff Director*

SUBCOMMITTEE ON DOMESTIC POLICY

DENNIS J. KUCINICH, Ohio, *Chairman*

ELIJAH E. CUMMINGS, Maryland
JOHN F. TIERNEY, Massachusetts
DIANE E. WATSON, California
JIM COOPER, Tennessee
PATRICK J. KENNEDY, Rhode Island
PETER WELCH, Vermont
BILL FOSTER, Illinois
MARCY KAPTUR, Ohio

JIM JORDAN, Ohio
MARK E. SOUDER, Indiana
DAN BURTON, Indiana
MICHAEL R. TURNER, Ohio
JEFF FORTENBERRY, Nebraska
AARON SCHOCK, Illinois

JARON R. BOURKE, *Staff Director*

CONTENTS

BANK OF AMERICA AND MERRILL LYNCH: HOW DID A PRIVATE DEAL TURN INTO A FEDERAL BAILOUT? PART V

FRIDAY, DECEMBER 11, 2009

HOUSE OF REPRESENTATIVES, COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM, JOINT WITH THE SUBCOMMITTEE ON DOMESTIC POLICY,

Washington, DC.

The committee and subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Edolphus Towns (chairman of the Committee on Oversight and Government Reform) presiding.

Present: Representatives Towns, Cummings, Kucinich, Tierney, Clay, Watson, Connolly, Quigley, Cuellar, Speier, Issa, Duncan, Bilbray, Jordan, Flake, Luetkemeyer, and Cao.

Staff present: John Arlington, chief counsel—investigations; Jean Gosa, clerk; Adam Hodge, deputy press secretary; Carla Hultberg, chief clerk; Marc Johnson and Ophelia Rivas, assistant clerks; Mike McCarthy, deputy staff director; Jenny Rosenberg, director of communications; Joanne Royce, senior investigative counsel; Leneal Scott, IT specialist; Christopher Staszak, senior investigative counsel; Ron Stroman, staff director; Gerri Willis, special assistant; Alex Wolf, professional staff member; Jaron Bourke, staff director, Subcommittee on Domestic Policy; Lawrence Brady, minority staff director; John Cuaderes, minority deputy staff director; Rob Borden, minority general counsel; Jennifer Safavian, minority chief counsel for oversight and investigations; Frederick Hill, minority director of communications; Adam Fromm, minority chief clerk and Member liaison; Kurt Bardella, minority press secretary; Seamus Kraft, minority deputy press secretary; Christopher Hixon, minority senior counsel; Hudson Hollister, minority counsel; and Brien Beattie and Mark Marin, minority professional staff member.

Chairman TOWNS. The committee and subcommittee will come to order. Good morning and thank you for being here.

The committee's investigation into Bank of America's acquisition of Merrill Lynch has resulted in an unprecedented look behind the scenes of one of the biggest bailouts in American history. Did the Federal Government force Bank of America to go through with the merger? Every Bank of America senior executive involved has told the committee that the government did not force them to go through with it. In fact, they told us they decided to go through with the deal because they thought it was in the best interests of Bank of America and its shareholders. Ken Lewis also testified that no one in the Government did anything improper during this transaction.

If there are still people who want to say the Government forced Bank of America to go through with the deal, they are turning a blind eye to the facts we now have before us. Over the course of this 8-month investigation, the committee has held five hearings, received extensive testimony from top executives at Bank of America and senior Government officials, conducted numerous interviews, issued two unprecedented subpoenas to the Federal Reserve for internal records, and reviewed nearly half a million documents.

Most importantly, public scrutiny and oversight by this committee has produced tangible results. Two days ago, Bank of America paid back its entire $45 billion Federal loan plus interest. In addition, under pressure from the committee, Bank of America agreed in September to pay $425 million to the Treasury Department in compensation for toxic asset insurance the bank received but never paid for.

In sum, our bipartisan investigation has resulted in the American taxpayers receiving approximately $47½ billion. Even in today's world, that is real money.

Every member of this committee should be proud of our efforts, and I take the time to salute you for your involvement and your hard work that has been great to get to this point.

While we have thoroughly examined all these issues involved in this case, I agreed to grant the ranking member's request for one more hearing to tie up some loose ends that he is concerned about. This will close the committee's full, fair, and successful investigation of the Bank of America-Merrill Lynch merger.

On that note, I thank you; and I yield to the ranking member of the committee, the gentleman from California, Congressman Darrell Issa.

[The prepared statement of Hon. Edolphus Towns attached:]

OPENING STATEMENT OF CHAIRMAN EDOLPHUS TOWNS
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

DECEMBER 11, 2009

"BANK OF AMERICA AND MERRILL LYNCH: HOW DID A PRIVATE DEAL TURN INTO A FEDERAL BAILOUT? PART V"

Good morning and thank you for being here today.

The Committee's investigation into Bank of America's acquisition of Merrill Lynch has resulted in an unprecedented look behind the scenes of one of the biggest bailouts in American history.

Did the Federal government force Bank of America to go through with the merger? Every Bank of America senior executive involved has told the Committee that the government did not force them to go through with it.

In fact, they told us they decided to go through with the deal because they thought it was in the best interests of Bank of America and its shareholders. Ken Lewis also testified that no one in the government did anything improper during this transaction.

If there are still people who want to say the government forced Bank of America to go through with this deal, they are turning a blind eye to the facts we now have before us.

Over the course of this eight month investigation, the Committee has held five hearings; received extensive testimony from top executives at Bank of America and senior government officials; conducted numerous interviews; issued two unprecedented subpoenas to the Federal Reserve for internal records; and reviewed nearly half a million documents.

Most importantly, public scrutiny and oversight by this Committee has produced tangible results:

- This week, Bank of America paid back its entire $45 billion Federal loan, plus interest.

- In addition, under pressure from this Committee, in September, Bank of America agreed to pay $425 million to the Treasury Department in compensation for toxic asset insurance the bank received, but never paid for.

In sum, our bipartisan investigation has resulted in the American taxpayer recovering approximately $47.5 billion. Even in today's world, that is real money, and every member of this Committee should be proud of our efforts.

While I believe that we have thoroughly examined all the issues involved in this case, I agreed to grant the Ranking Member's request for one more hearing to tie up some loose ends that he is concerned about. This will close the Committee's full, fair, and successful investigation of the Bank of America-Merrill Lynch merger.

Thank you.

For immediate release: Thursday, September 10, 2009
Contact: Jenny Rosenberg, 202-225-5051

Chairman Towns Calls on Bank of America to Stop Stonewalling and Repay the Taxpayers

Bank yet to acknowledge it owes taxpayers for key bailout provision

Washington, D.C. — Chairman Edolphus "Ed" Towns (D-NY) today released a letter from Bank of America (BOA) CEO Kenneth Lewis in which BOA refuses to acknowledge its agreement with the United States Government over "insurance" or "ringfencing" the bank requested as part of its January 2009 bailout.

"Bank of America has conveniently erased from its memory the terms of the ringfencing agreement. It seems that the bank wants to have it both ways – all the benefits of government insurance without having to pay a dime for all of its benefits," said Chairman Towns. "I urge Bank of America to put an end to this stonewalling by acknowledging the ringfencing agreement, and to quickly and effectively resolve this dispute with the Federal government."

Chairman Towns initially wrote Mr. Lewis on July 14, 2009, expressing concern over BOA's failure to honor the agreement, and to pay back the government for the agreed upon insurance. Currently, BOA is disputing the Department of Treasury's claim that the bank owes the Federal government for financial benefits it received as a result of the ringfencing agreement.

The Chairman's July letter stated, "If you or anyone at Bank of America made a commitment, verbal or otherwise, to enter into this deal with the United States Government, I urge you to honor that commitment to the government and the American people."

Despite BOA's current denial of a ringfencing agreement, the bank publicly announced the arrangement in a January 16, 2009 press release. The same release announced the $20 billion taxpayer bailout BOA received after having difficulty completing its purchase of Merrill Lynch.

Referring to the ringfencing protection in the press release, BOA stated, "...the government has agreed to provide protection against further losses on $118 billion in selected capital markets exposure, primarily from the former Merrill Lynch portfolio."

Mr. Lewis and Bank of America Chief Financial Officer Joseph Price also discussed the ringfencing benefit in a conference call on January 16, 2009, when the bailout was announced. During that call, Mr. Price referred to the ringfencing agreement as "...essentially insurance, against significant downside risk on a pool of $118 billion in capital markets related exposures." In contrast, Mr. Lewis' most recent letter to Chairman Towns refers to the ringfencing arrangement as a "proposed agreement."

Chairman Towns stated, "I am disappointed to learn that Bank of America has not resolved this matter. Nearly eight months after receiving a taxpayer bailout, Mr. Lewis' letter offers no acknowledgement of the agreement despite the fact that Bank of America clearly stated they negotiated a ringfencing agreement with the Federal government."

Earlier this year, Chairman Towns opened an investigation into the events surrounding the BOA-Merrill Lynch merger and the role the federal government played in the transaction. To date, the Committee has held three hearings on the Bank of America-Merrill Lynch merger, receiving testimony from BOA CEO Kenneth Lewis, Federal Reserve Board Chairman Ben Bernanke and then-Treasury Secretary Henry Paulson. Chairman Towns also subpoenaed internal email communications and other documents from the Federal Reserve.

A copy of Mr. Lewis' September 9, 2009 response to Chairman Towns is attached.

A copy of Chairman Towns' July 14, 2009 letter to Mr. Lewis is attached.

###

ONE HUNDRED ELEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

2157 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6143

MAJORITY (202) 225-5051
FACSIMILE (202) 225-4784
MINORITY (202) 225-5074

www.oversight.house.gov

July 14, 2009

Mr. Kenneth D. Lewis
Chief Executive Officer and President
Bank of America Corporation
Bank of America Corporate Center
100 N. Tryon Street
Charlotte, NC 28202

Dear Mr. Lewis:

I am troubled by a Bloomberg News report issued today which states that Bank of America is refusing to compensate the Federal government for the $118 billion in financial protection the U.S. provided to Bank of America in January 2009. By all accounts, this announcement of this so-called "ring-fencing" of Bank of America's toxic assets provided financial stability to Bank of America at a very crucial time for the company.

This agreement was obviously beneficial to Bank of America. You reported it to the public in your earnings press release issued on January 16, 2009, and it was discussed by you personally on a Bank of America earnings conference call with investors on the same date. In addition, documents that this Committee uncovered through its investigation of the Bank of America-Merrill Lynch acquisition suggest that Bank of America requested this backstop.

Apparently, Bank of America believes it has the right to back out of this deal with the government because the agreement was never signed. If this is true, I must note the irony of such an argument. As you have stated under oath, Federal Reserve Chairman Ben Bernanke and then-Treasury Secretary Hank Paulson made verbal commitments to you in December of 2008 to provide Bank of America with billions of taxpayer dollars to help your bank absorb the losses at Merrill Lynch. What would have happened to Bank of America if the government had not honored the verbal commitments you say were made to you? What would you have thought of Chairman Bernanke and Hank Paulson if they had backed out of their verbal commitment to you?

If you or anyone at Bank of America made a commitment, verbal or otherwise, to enter into this deal with the United States Government, I urge you to honor that commitment to the government and to the American people. It is the right thing to do.

Mr. Kenneth D. Lewis
Page 2

Please provide me with an update no later than July 16, 2009, as to the current status of this dispute with the government.

Should you have any questions regarding this request, please contact John Arlington or Christopher Staszak of the Committee staff at 202-225-5051.

Sincerely,

Edolphus Towns
Chairman

cc: Darrell Issa, Ranking Minority Member
Committee on Oversight and Government Reform

Bank of America

September 21, 2009

Hon. Edolphus Towns, Chairman
Committee on Oversight and Government Reform
United States House of Representatives
2157 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Towns:

I write in further response to your letter of July 14, 2009, requesting an update on the status of negotiations to terminate a proposed agreement between Bank of America Corporation and the United States Government to provide a guarantee in the event of unusually large losses on an asset pool of up to $118 billion in financial instruments.

As I explained in my letter of September 9, we have been in discussions with the Government since April regarding an appropriate financial resolution of the above-referenced matter. I am pleased to inform you that today, we reached an agreement with the Treasury Department, Federal Reserve and Federal Deposit Insurance Corporation. A copy of the agreement is attached to this letter.

We appreciate your interest and leadership, and the interest of the Committee, in oversight of this issue and other matters of importance to the American taxpayers. Please let us know if we can be of any further assistance.

Sincerely,

Kenneth D. Lewis
Chief Executive Officer and President

cc: Hon. Darrell E. Issa, Ranking Member

Enclosures

THE WALL STREET JOURNAL.
WSJ.com

NOVEMBER 17, 2009

Bank of America Threatened to Walk Away From Merrill Deal

By MICHAEL R. CRITTENDEN

WASHINGTON -- Bank of America Corp.'s lawyers told its executives that it would be difficult for the bank to pull out of its deal to buy Merrill Lynch & Co., but the executives still threatened to walk away, prompting the government to provide another $20 billion in aid to get the merger done.

U.S. House lawmakers Tuesday are expected to grill BofA's Brian Moynihan and other officials over handwritten notes and memos from the bank and its outside counsel, which were written when Bank of America was considering pulling out of the Merrill deal.

Rep. Edolphus Towns (D, N.Y.), chair of the House Oversight and Government Reform Committee, has suggested the high-stakes negotiations between government officials and Bank of America may have been a "shakedown" to get more aid from the government. Bank of America disputes such a characterization.

In a series of high-profile hearings, the panel has heard from former Treasury Secretary Henry Paulson and has splashed the emails of Federal Reserve Chairman Ben Bernanke. It also contributed to the recent decision by BofA Chief Executive Kenneth Lewis to step down.

The spotlight comes at an inopportune time for Mr. Moynihan, president of Bank of America's consumer and small business banking segment. He and Chief Risk Officer Gregory Curl are internal front-runners to take over from Mr. Lewis.

The panel is expected to press him about his role in Bank of America reaching a conclusion it could abandon the Merrill deal, according to people familiar with matter. Mr. Moynihan was named general counsel at the height of the bank's deliberations on the matter.

Tuesday's hearing could be the final chapter in a months-long effort by the panel to shed light on a key event of the financial crisis: the negotiations over whether BofA would complete the Merrill acquisition.

Key to the hearing will be new documents obtained by investigators that show uncertainty on the part of the bank's outside lawyers about its ability to successfully abandon the Merrill deal. Lawyers at Wachtell, Lipton, Rosen & Katz raised a number of doubts about the bank invoking a "material adverse change" clause—the required legal basis for walking away-saying in a Dec. 15 memo "we would need more data to analyze this."

Two days later, Mr. Lewis called Mr. Paulson and warned that the bank might abandon Merrill because of mounting losses, citing its willingness to invoke the clause.

Bank of America spokesman Larry Di Rita said the documents don't tell the complete story of the bank's deliberations. "There was alignment or consensus among outside counsel, internal counsel, and the senior leaders of the company that there was a good-faith basis for a MAC," Mr. Di Rita said.

Other documents obtained by the panel suggest Wachtell lawyers came around on the idea of invoking the clause. One attorney said in handwritten notes Dec. 20 he was "warming to the case" for the clause, according to people familiar with the documents.

Write to Michael R. Crittenden at Michael R. Crittenden@wsj.com

Bank of America Completes Repayment of TARP

CHARLOTTE, N.C., Dec. 9 /PRNewswire/ -- Bank of America today sent the U.S. Treasury $45 billion to repay the U.S. taxpayers' entire investment in the company as part of the Troubled Asset Relief Program (TARP). Repayment followed the successful completion of a securities offering.

(Logo: http://www.newscom.com/cgi-bin/prnh/20050720/CLW086LOGO-b)

As previously announced, the company sold 1.286 billion common equivalent securities, generating gross proceeds of approximately $19.29 billion. The offering was priced at $15.00 per common equivalent security and its proceeds, along with existing corporate funds, were used to repurchase all the preferred stock issued to the U.S. Department of the Treasury. The company also paid the government $190 million in accrued dividends on the repurchased preferred securities.

In repaying TARP, Bank of America today repurchased all 600,000 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series N; all 400,000 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series Q; and all 800,000 shares its Fixed Rate Cumulative Perpetual Preferred Stock, Series R. The U.S. Treasury continues to hold warrants to buy Bank of America common stock issued as part of the TARP investments.

"We owe taxpayers our thanks for making these funds available to the nation's financial system and to our company during a very difficult time," said Chief Executive Officer and President Kenneth D. Lewis. "Now that we have cleared this significant hurdle, which demonstrates the strength of our company, we look forward to continuing to play a key role in the economic recovery and helping to meet the changing needs of our customers and clients."

Following the completed securities offering, Bank of America also would increase equity by approximately $3 billion through asset sales to be approved by the Board of Governors of the Federal Reserve and contracted for by June 30, 2010.

As previously announced, Bank of America also agreed to raise up to approximately $1.7 billion through the issuance of restricted stock in lieu of a portion of incentive cash compensation to certain Bank of America associates as part of their normal year-end incentive payments. Year-end incentive payments are dependent on the performance of the company, business units and individuals and have not yet been determined. This initiative also aligns associate interests with the company's performance.

With the repayment of TARP funds and these other initiatives, the company's Tier 1 Capital ratio would be 11.0 percent, pro forma based on the September 30, 2009 ratio of 12.5 percent. The Tier 1 Common capital ratio would be 8.4 percent, pro forma based on the September 30, 2009 ratio of 7.3 percent.

BofA Merrill Lynch served as the sole bookrunner for the common equivalent securities offering and UBS Investment Bank served as co-manager and qualified independent underwriter.

Bank of America

Bank of America is one of the world's largest financial institutions, serving individual consumers, small- and middle-market businesses and large corporations with a full range of banking, investing, asset management and other financial and risk management products and services. The company provides unmatched convenience in the United States, serving approximately 53 million consumer and small business relationships with 6,000 retail banking offices, more than 18,000 ATMs and award-winning online banking with more than 29 million active users. Bank of America is among the world's leading wealth management companies and is a global leader in corporate and investment banking and trading across a broad range of asset classes serving corporations, governments, institutions and individuals around the world. Bank of America offers industry-leading support to more than 4 million small business owners through a suite of innovative, easy-to-use online products and services. The company serves clients in more than 150 countries. Bank of America Corporation stock (NYSE: BAC) is a component of the Dow Jones Industrial Average and is listed on the New York Stock Exchange.

www.bankofamerica.com

Photo: http://www.newscom.com/cgi-bin/prnh/20050720/CLW086LOGO-b

SOURCE: Bank of America

Web site: http://www.bankofamerica.com/

Exhibit Book

December 11, 2009 Hearing on
"Bank of America and Merrill Lynch: How did a Private Deal Turn Into a Federal Bailout? Part V"

Chairman Edolphus Towns

Committee on Oversight & Government Reform
U.S. House of Representatives

The Wall Street Journal

BUSINESS

DECEMBER 3, 2009

BofA Set to Repay Taxpayers

Bank Raising $18.8 Billion to Exit Treasury Grip After Rescue; Curbs Hurt CEO Search

By DAN FITZPATRICK, DEBORAH SOLOMON and DAVID ENRICH

Bank of America Corp. reached an agreement to repay $45 billion in federal bailout funds and escape pay restrictions and other curbs imposed by the U.S. government.

Wednesday's announcement means the Charlotte, N.C., bank will be the first of seven companies to return their large, or "exceptional," taxpayer-funded lifelines. Bank of America got $25 billion in October 2008 through the Troubled Asset Relief Program as officials scrambled to steady the U.S. financial system. It received an additional $20 billion in January to help digest its takeover of securities firm Merrill Lynch & Co.

Bank of America's agreement to repay $45 billion in federal bailout funds allows it to escape pay limits imposed by the U.S. government. Dow Jones's Arindam Nag and Michael Reid talk about what this indicates about the health of the banking sector.

While Bank of America is struggling to overcome recessionary pressures, which have caused loan losses to balloon, its $6.47 billion profit through the end of September was down just 12% from a year earlier. Because of its improved health, Bank of America officials had been pushing to repay the government. Federal officials refused to allow it until they were confident the bank was strong enough.

That Bank of America is in position to repay its investment, and raise new capital, is a sign of how much the financial sector has strengthened over the past year. The bank received so much government aid largely because private investors were unwilling to pony up -- a situation that has now changed.

But Bank of America also is paying a high price for its exit, showing the lengths companies will go to get out from under the government's thumb. It plans to raise about $18.8 billion in new equity through the sale of securities, a move required by federal regulators to ensure the bank has sufficient capital reserves and will not need to come back to the government for additional aid, according to people familiar with the matter. The remaining amount will come from current liquidity, Bank of America said.

The deal was negotiated in large part by Gregory Curl, Bank of America's chief risk officer and a contender to succeed Kenneth Lewis as chief executive of the nation's largest bank in assets. Mr. Lewis announced Sept. 30 that he would retire at year-end. A person familiar with the process said directors have made no decision on Mr. Lewis's successor. Mr. Curl headed a team that has spent the past two months in Washington, D.C., hammering out the deal. Mr. Lewis has said he wanted a deal before he leaves the company.

Another executive in the running for the top job, consumer and small-business banking chief Brian Moynihan, has been working with Obama administration officials on overdraft, credit-card and small-business issues. The bank is seeking to align its consumer-banking policies with new legislation and rules.

As one of the seven companies that received "exceptional assistance" from the government, Bank of America has been subject to tougher restrictions than other financial firms, including having pay set and reviewed by Kenneth Feinberg, the Treasury Department's special master for compensation. Those restrictions have complicated the search for Mr. Lewis's successor, say people familiar with the process. One potential contender, PNC Financial Services Vice Chairman Bill Demchak, spurned a feeler from a recruiter because of Mr. Feinberg's required approval of the compensation package.

Repaying the government frees Bank of America from Mr. Feinberg's pay review, according to people familiar with the talks. But like other companies that participated in TARP, Bank of America still will be subject to a "look-back" provision that allows Mr. Feinberg to claw back money if he deems payments made not in the public interest.

Bank officials have no intention of promptly jacking up its top executives' compensation to the levels that preceded Mr. Feinberg's review, said a person familiar with the company. The U.S. must dispose of warrants it received as part of its investment, which allows it to purchase common stock at a given price. Bank of America can agree to buy back the warrants, or the Treasury can auction them to other bidders.

Treasury officials were eager to allow the repayment. But discussions bogged down with some regulators initially disagreeing over what steps Bank of America had to take to satisfy concerns about its capital base. In order to win over hesitant parties, the bank agreed to a number of concessions: raising $18.8 billion in new capital; shifting some of its bonus pay to restricted stock instead of cash; and agreeing to shed $4 billion of assets.

"We discussed with them what they felt we needed and there was a negotiation around it," said Bank of America spokesman Robert Stickler. The $4 billion of assets the bank needs to get rid of will consist of business units or strategic investments, he said. Regulators won't allow the bank to sell loan portfolios as a way of shrinking its balance sheet.

The repayment likely will intensify pressure on other large recipients of government aid, including Wells Fargo & Co., which received $25 billion, and Citigroup Inc., which has received $45 billion, to get out from under the government's yoke.

As of October, 42 banks that received some form of government assistance have repaid more than $70 billion to the Treasury, including Goldman Sachs, J.P. Morgan Chase & Co., Morgan Stanley and a host of midsize banks. Bank of America and Citigroup were the only commercial banks to receive "exceptional" assistance from the U.S.

Citigroup Chief Executive Vikram Pandit has been vocal about his desire to repay the government, which holds a 34% stake in the wake of repeated federal rescues.

At a recent employee meeting, Mr. Pandit said he hopes to "repay the government as fast as possible, clearly with a debt of gratitude and also with a good rate of return....On that day, people will stop writing that Citi is a troubled bank with a $45 billion bailout package."

Write to Dan Fitzpatrick at dan.fitzpatrick@wsj.com, Deborah Solomon at deborah.solomon@wsj.com and David Enrich at david.enrich@wsj.com

Printed in The Wall Street Journal, page A1

From: Roth, Eric M.
Sent: Monday, December 15, 2008 11:47 AM
To: Herlihy, Edward D.; Demmo, Nicholas G.; Wolinsky, Marc
Subject: MAE analysis

Attachments: 1327771_1.DOC

1327771_1.DOC
(43 KB)

MAE ANALYSIS

In Section 3.8(a) of the Merger Agreement, MER represented and warranted that since June 27, 2008, "no event or events have occurred that have had or would reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect on Company."

MAE is defined in part as a "material adverse effect on (i) the financial condition, results of operations or business of such party and its Subsidiaries taken as a whole (provided, however, that with respect to clause (i), a "MAE" shall not be deemed to include effects to the extent resulting from . . . (D) changes in . . . general business, economic or market conditions, including changes generally in prevailing interest rates, currency exchange rates, credit markets and price levels or trading volumes in the United States or foreign securities markets, in each case generally affecting the industries in which such party or its Subsidiaries operate and including changes to any previously correctly applied asset marks resulting therefrom, . . . [or] (F) failure, in and of itself, to meet earnings projections, but not including any underlying causes thereof, . . . except, with respect to clauses (A), (B), and (D), to the extent that the effects of such change are **disproportionately adverse to the financial condition, results of operations or business of such a party and its Subsidiaries, taken as a whole, as compared to other companies in the industry** in which such party and its Subsidiaries operate) or (ii) the ability of such party to timely consummate the transactions contemplated by this Agreement."

Issue # 1 – durational significance

Under IBP, an MAE clause is intended to protect an acquiror from "the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner. A short-term hiccup in earnings should not suffice." 789 A.2d at 68. The court must consider whether there has been an adverse change in the target's business that is "consequential to the company's earnings power over a commercially reasonable period, which one would think would be measured in years rather than months." Id.

So, it is not enough to show a short-term earnings decline, no matter how severe. Must show decline in value over period of years, not months.

We would need more data to analyze this. What is the durational significance of the losses recently suffered on MER's monoline exposures and derivative product companies? Will the fact that MER has had to post so much cash collateral impact its future profitability? If so, how long and to what extent? What is the effect of these cash outflows on our valuation model?

Is it expected that MER will continue to be required to post collateral on these products in the future? What is the best estimate of those expected future cash outflows? What is their impact on our valuation model?

Issue # 2 – disproportionately adverse

To the extent that the losses on monoline exposures and derivative product companies is attributable to changes in market conditions, including changes generally in credit markets and price levels in the US or foreign securities markets under section D above, are the effects of such change disproportionately adverse to the financial condition, results of operations or business of MER and its subsidiaries, in comparison to other companies in the industry?

This requires both identifying the comparables and ascertaining the impact of the changes in the credit markets on them. MER's comparable companies probably include UBS, Goldman Sachs, Credit Suisse, Deutsche Bank and Morgan Stanley. Each of these entities has also been affected adversely by the changes in the credit and securities markets since June 28, but to what extent have the changes on MER been disproportionately adverse?

Getting the Q4 numbers on each of these entities is the beginning of wisdom, but since the definition of MAE turns on durationally significant effects, we cannot answer this question by reference to Q4 numbers alone. Based on publicly available information about these companies (including analyst reports, etc.), have these MER competitors been impacted in a durationally significant way?

From: Moynihan, Brian T <brian.t.moynihan@bankofamerica.com>
Sent: Friday, December 19, 2008 2:48 AM (GMT)
To: Brenner, Teresa -Legal <teresa.brenner@bankofamerica.com>
Subject: Fw: Talking points -- PRIVILEGED AND CONFIDENTIAL
Attach: 1329514_1.DOC

Fyi
Brian

Sent using BlackBerry

From: EMRoth@wlrk.com
To: Moynihan, Brian T
Cc: EDHerlihy@wlrk.com ; NGDemmo@wlrk.com ; PCHein@wlrk.com ; RKim@wlrk.com ; MGuest@wlrk.com
Sent: Thu Dec 18 20:48:25 2008
Subject: Talking points -- PRIVILEGED AND CONFIDENTIAL

<<1329514_1.DOC>> Brian – As discussed, a draft of Ken's litigation-related talking points. Eric

PRIVILEGED AND CONFIDENTIAL

Talking Points

Given the very poor performance of MER in the fourth quarter, we have asked our legal team to focus on the company's rights under the Merger Agreement and the applicable law, including whether we are obligated to close on the transaction.

At first blush, those of us who aren't lawyers might think that these terrible fourth quarter numbers -- an $12.5 billion dollar after-tax loss – gives rise to a "material adverse change" and gives us the right to walk away from the merger.

But if we do terminate the Merger Agreement, we can expect MER to initiate litigation.

Our merger agreement is governed by Delaware law, and the Delaware courts have addressed the meaning of "material adverse change" several times.

MER will likely argue that the Delaware courts have set up a **very high threshold** for proving a "MAC" -- that the acquiror needs to show that **"unknown events"** have occurred that **"substantially threaten the overall earnings potential of the target"** in what the courts call **"a durationally significant manner."**

And MER will no doubt point out that, applying this standard, no Delaware court has ever found that a MAC occurred permitting an acquiror to terminate a merger agreement.

1. Unknown events

Focusing first on the issue of "unknown events," if this matter went to litigation with MER, we can expect that they would argue that when we entered into the Merger Agreement, our side was aware of the volatility inherent in MER's business as well as the significant dislocations in the financial markets that were already affecting the business of MER and its competitors.

We can also expect MER to argue that BAC was aware not only of these general risks, but the specific risks inherent in the business lines that have resulted in MER's large losses in Q4.

MER's Q4 losses are largely attributable to the weak state of the credit markets. For example, the widening of credit spreads has resulted in MER being required to write down some $3.9 billion of exposures to monolines and other insurers and another $1.4 billion on their correlation book.

W/1329514v1

MER would no doubt claim that BAC was aware of the risk inherent in these potential exposures because they were all on MER's books at the time we engaged in due diligence. For example, through the first 3 quarters of 2008, MER wrote down $7.2 billion on its monoline insurer exposure.

In addition, another significant portion of the expected Q4 loss is attributable to "hung deals" -- some $1.4 billion in LBO debt that MER has been unable to syndicate. MER would argue that BAC was aware at the time the Merger Agreement was signed that MER had a number of "hung deals" on its books and that MER had already taken sizable marks on a number of these deals.

2. "Durational significance"

Then, there is the issue of "durational significance."

MER will point out that **a short-term earnings decline – no matter how severe -- is not enough** to prove a MAC because the courts assume that an acquiror is purchasing the target as part of a long-term strategy.

MER will say that the test is whether the adverse change will be "consequential to the company's earnings power over a commercially reasonable period," which is "measured in years rather than months."

So we can expect MER to claim that, in order to prove a MAC here, BAC must show that the losses that MER has suffered in Q4 are going to persist "**significantly into the future**" and that its profitability will be negatively impacted for **years, not months.**

It is **not clear** that we would be able to prove that.

As I have noted, MER's Q4 losses are largely attributable to the extremely challenging conditions in the credit markets – the widening of credit spreads has resulted in MER being required to make huge credit valuation adjustments on its credit default swaps with financial guarantors and to take write-downs on its so-called correlation book.

MER will assert that credit spreads will eventually narrow, and that the performance of MER's credit desk and proprietary trading operation will improve as a result.

MER will also argue that, even if you assume a static market, over time, as you get closer to maturity, the losses that MER has incurred on its correlation book will be recouped (assuming no defaults by counterparties).

3. "Substantial threat to overall earnings potential"

And, then there is the issue of showing a "substantial threat" to MER's "overall earnings potential.

MER will argue that the Delaware courts determine whether a MAC has occured based on an examination of the target's business as a whole. Even if one or two divisions of a company are materially impaired, the court will not find a MAC unless it concludes that the company's profitability as a whole has been materially impaired as a result.

There is no question that MER's fixed income desk has had an awful quarter, but MER will assert that other portions of the MER business are not performing badly.

For example, revenues from Global Wealth Management, are expected to come in at $2.8 billion for Q4, not far below the Q3 revenues of $3.0 billion.

Equity trading revenues are expected to come in at $1.2 billion for Q4, only slightly less than the $1.36 billion in Q3 revenues.

There is no question that MER's problems in Q4 have reduced its Tier 1 capital by some $12 billion. MER will point out, however, that it is eligible to receive $10 billion in TARP money, which provides a significant offset to that amount.

4. "Disproportionately adverse"

In deciding whether there has been a MAC here, the Delaware courts will also consider the terms of the Merger Agreement to see whether and how it modifies their definition of a MAC.

The Merger Agreement here has a fairly standard carve out from the definition of a MAC for changes in general business, economic or market conditions, including changes in the credit and securities markets, except to the extent that the effects of these changes are "dispro-portionately adverse" to MER relative to others in the industry.

While we would point to the fact that Goldman Sachs and Morgan Stanley had better fourth quarters than MER – their respective losses for the quarter were about $2 billion after-tax, not $12 billion – MER would make a number of counter-arguments, including that the comparable companies in the industry should include Lehman, which of course went bankrupt, and that the relevant time period is "measured in years, not months."

5. Other relevant factors

Putting to one side the difficulty of proving a MAC under Delaware law, our lawyers point out other factors that we ought to consider in deciding whether to go to court over this deal.

One thing to keep in mind is the potential downside if we litigate this and lose. If we walk away from this deal, it is very likely that MER will either file a chapter 11 petition or will receive a government bailout. Our litigation adversary might well be a chapter 11 trustee or the federal government – which would create a different litigation dynamic than if our adversary is the current MER management and board.

The other thing to keep in mind is that MER may take the position that, if we fail to show that a MAC has occurred, it is entitled to an order of "specific performance" -- that is, an order that requires us to close on the deal on the originally negotiated terms.

Our lawyers at Wachtell advise us that, several years ago, in the IBP-Tyson case, they succeed in getting the Delaware court to order specific performance of a merger agreement only 2 ½ months after the buyer declared a MAC.

The potential danger here is that, if we declare a MAC and MER's business loses even more value as a result because, for example, retail customers pull their funds out, and then we litigate the MAC issue and lose, we could be required to close on a deal where MER is worth even less than it is today.

If MER fails to obtain specific performance, it will argue that it is entitled to collect substantial damages on the ground that the BAC's failure to consummate the merger led to MER's demise.

12/20/08

Ed Hedlicky

calls yesterday w/ reg. didn't go well
Ben, Baxter - ... to call MAC
won't hear anything till Monday

Redacted

12/20/08

MOYNIHAN
BUST
KIM
HEALTHY
PRICE

(1) ML - warning to no cap
Hatch/Hixon - 33%

(2) regs share price doesn't address capital
ML hardball push on MAC,
the worst stage put

Threat of MAC - don't push too far -
turn against us

H. Hlush - regulators don't want to help
don't want to use MAC

altern. trans. -
how explain what happened?

What went wrong?
Paulson - how explain to world?

From: Gifford, Chad
Sent: Thursday, January 15, 2009 6:03 PM
To: May, Thomas
Subject: RE: Are you available.

Amaaazing...

From: May, Thomas [Redacted]
Sent: Thursday, January 15, 2009 6:02 PM
To: Gifford, Chad
Subject: RE: Are you available.

good comeback. Holy shit on the people

From: Gifford, Chad [mailto:chad.gifford@bankofamerica.com]
Sent: Thursday, January 15, 2009 6:00 PM
To: May, Thomas
Subject: RE: Are you available.

Only stated in the context of a horrible economy!!! Will effect everyone...

From: May, Thomas [Redacted]
Sent: Thursday, January 15, 2009 5:59 PM
To: Gifford, Chad
Subject: RE: Are you available.

No trail

From: Gifford, Chad [mailto:chad.gifford@bankofamerica.com]
Sent: Thursday, January 15, 2009 5:57 PM
To: May, Thomas
Subject: RE: Are you available.

Unfortunately it's screw the shareholders!!

From: May, Thomas [Redacted]
Sent: Thursday, January 15, 2009 5:56 PM
To: Gifford, Chad
Subject: RE: Are you available.

Screw You

From: Gifford, Chad [mailto:chad.gifford@bankofamerica.com]
Sent: Thursday, January 15, 2009 5:54 PM
To: May, Thomas
Subject: RE: Are you available.

Concentrate on the phone !!!

From: May, Thomas [Redacted]
Sent: Thursday, January 15, 2009 5:53 PM
To: Gifford, Chad
Subject: RE: Are you available.

WOW

From: Gifford, Chad [mailto:chad.gifford@bankofamerica.com]
Sent: Thursday, January 15, 2009 5:51 PM
To: May, Thomas
Subject: FW: Are you available.

interesting

From: De Molina, Al [mailto:al.demolina Redacted]
Sent: Thursday, January 15, 2009 5:27 PM
To: Gifford, Chad
Subject: Are you available.

From: Gifford, Chad
Sent: Wednesday, December 10, 2008 2:56 PM
To: Wbarnet3 Redacted
Subject: RE: yesterday

yes yes and yes...and it's the way we approved acquisitions that tick me off the most !!!

From: Wbarnet3 Redacted [mailto: Redacted ted]
Sent: Wednesday, December 10, 2008 2:50 PM
To: Gifford, Chad
Subject: Re: yesterday

thanks....we making progress and board getting it..but fear we let this get too far down the path...will be a very tough year and "plan" seems unrealistic from today's perspective...all best...

In a message dated 12/10/2008 9:02:30 A.M. Eastern Standard Time, chad.gifford@bankofamerica.com writes:

> agree with everything...many mnay challenges and a bit scary willing to let Brian go...notwithstanding fleet he's a key character in undersatnding all that's on plate-and disagree with Frank re the need to keep our stars!! But seems ken heard us a bit and at least we had an executive discussion with many seemingly agreeing...we'll see and best back to our south caralinian friends
>
> ---
>
> **From:** Wbarnet3 Redacted [mailto: Redacted ted]
> **Sent:** Wednesday, December 10, 2008 5:51 AM
> **To:** Gifford, Chad
> **Subject:** yesterday
>
> glad (I hope) Brian got saved....last of the Fleet guys and good person and team player...not sure what it does to Tim M...
>
> numbers were numbing....too fast and overwhelming...ML equally amazing.
>
> no mention, except in passing, of holiday greetings...
>
> much pressure..felt KL feeling it...
>
> best to you and your family..
>
> ---
>
> Stay in touch with ALL of your friends: update your AIM, Bebo, Facebook, and MySpace pages with just one click. Redacted

From: wbarnet Redacted
Sent: Friday, November 21, 2008 6:20 PM
To: Gifford, Chad
Subject: Re: today

thanks...will be around early in week...can chat...just hope our team has honest view of world..$11 is unbelieveable...best to Anne and have a good weekend.

-----Original Message-----
From: Gifford, Chad <chad.gifford@bankofamerica.com>
To: Wbarnet Redacted
Sent: Fri, 21 Nov 2008 4:05 pm
Subject: RE: today

sorry we haven't connected...no not much after 11;15...agree re tom and glad kl responded as he did re citi...but thought his response to tom re ramnifications of low stock price was arrogant...they do feel # 1 and maybe yes re overall strength but market sure doesn't-although JPM has had an even rougher few days while Wells doing much better...for whatever reasons I hung up feeling better than i expected but that perhaps because my expectations were low...happy thanksgiving but will call early in week to compare further best and good w/e too !!!

From: Wbarne! Redacted
Sent: Friday, November 21, 2008 2:32 PM
To: Gifford, Chad
Subject: today

had to get off at 11:15...did anything jump up after that point?.....thought Tom may was good, as were you...some pushback...I get sense we feel we #1..think others feels JP Morgan Chase is doing the best job....we still sinking ...have a good weekend.

Check out smokin' hot deals on laptops, desktops and more from Dell. Shop Deals

Witness List

Committee on Oversight and Government Reform

Hearing Entitled, "Bank of America and Merrill Lynch: How Did a Private Deal Turn Into a Federal Bailout?" (Part IV)

Tuesday, November 17th 2009

Panel I

- **Timothy J. Mayopoulos**
  General Counsel of Bank of America until December 10, 2008

- **Brian Moynihan**
  President of Consumer and Small Business Banking
  Bank of America

- **Charles "Chad" Gifford**
  Member of the Bank of America Board of Directors

- **Thomas J. May**
  Member of the Bank of America Board of Directors

Mr. ISSA. Thank you, Mr. Chairman, and thank you for holding this hearing.

I have already told the chairwoman that, quite frankly, I do believe she is the bookend of this investigation. She is the bookend because Tim Geithner has never appeared before us. She is the bookend because, in fact, there never really was much there. Bank of America is a regulated bank. Moneys were made available on an extraordinary basis and have now been paid back.

Today, in the short time that we will take of the chairwoman, we in the minority will ask, where do we go from here? The security of our banks, FDIC-insured banks, the future of banks conveniently becoming banks in times of trouble and perhaps not being banks in other times, these are important questions that this committee should ask not because we are the Financial Services Committee but because we are the watchdog of the American dollar and the American process and the laws that are passed that the executive branch and its affiliates must adhere to.

Mr. Chairman, I am deeply concerned that in your opening statement you, quite understandably, said that the American people were paid back $45 billion with interest, over $47 billion. I must caution you, the American people didn't get a penny back. That money has not come back to the American people. In fact, it has simply been put back into the slush fund that was created under a Republican President with Tim Geithner and Hank Paulson's assistance; and today, in fact, not a penny has been paid back to the American people. That money is being recycled into do-good causes or whatever the President and this administration would like to do.

Mr. Chairman, I look forward to us getting the American people's money back as it was promised. We were told that, in fact, we would be paid back all of our money, and probably with interest. Mr. Chairman, unless that money comes back immediately, when you look at Chrysler, General Motors, and, of course, $31-plus billion to AIG that Tim Geithner himself has now said we will not get back, it is clear that even if all the other moneys given to various organizations through a process of buying mostly preferred debt, if in fact all of that is paid back with interest, the offset of the money that we now know we are going to lose would barely make us whole without considering interest as anything other than principal payback.

So Mr. Chairman, this is the bookend. We have only a few questions for our esteemed witness, and we appreciate your bringing her here today. But this is not the end of protecting the American people's money, not the end of this committee's jurisdiction of ensuring that the intent of law becomes the fact in law.

With that, I thank the chairman and yield back.

Chairman TOWNS. I thank the gentleman for his statement. And maybe what we can do with some of this $47½ billion is use it to create jobs and job opportunities. So maybe that is a good way to use it.

Mr. ISSA. Mr. Chairman, I would certainly appreciate a bill authorizing that and appropriating that through the Congress. And I look forward to working with you on such a piece of legislation, which is our constitutional responsibility.

Chairman TOWNS. Thank you very much. I appreciate the gentleman's offer and look forward to working with you.

Mr. CONNOLLY. Mr. Chairman? Would the ranking member yield?

Chairman TOWNS. Actually——

Mr. ISSA. The Chair certainly could.

Mr. CONNOLLY. Would the chairman allow me to just respond to something the ranking member said?

Chairman TOWNS. Very quickly.

Mr. CONNOLLY. Very quickly. I just want the ranking member to know there are Members on this side of the aisle who share his view about the need to address the deficit and that the first obligation of the repayment of TARP money or the use of unused TARP money ought to be that.

Mr. ISSA. Thank you.

Chairman TOWNS. Thank you very much.

As this hearing is being conducted by the Domestic Policy Subcommittee, of course, and they have done a superb job in working with us on this issue, I now would like to yield 5 minutes to the gentleman from Cleveland, OH, Mr. Kucinich, the Chair of that subcommittee.

Mr. KUCINICH. Thank you very much, Mr. Chairman, Mr. Issa, members of the committee.

On December 5, 2008, the shareholders of Bank of America voted to approve a merger with Merrill Lynch. Only 12 days later, Ken Lewis, CEO of Bank of America, made a call to then-Secretary of Treasury Hank Paulson, initiating a process that led to a $20 billion bailout of the merger and a promise of government insurance for losses of up to $118 billion.

The chronology of events strained belief. Was it true that the financial situation at Merrill Lynch shifted so dramatically in that short amount of time, as Ken Lewis said? Or did top management know, or should they have known, about the deteriorating situation at Merrill Lynch much earlier? Did they fail to make necessary disclosures to the shareholders? Bank of America would be in legal jeopardy if it failed to disclose to shareholders information about large accelerating losses at Merrill Lynch known or knowable before the shareholder vote.

The Domestic Policy Subcommittee investigation has found evidence of possible security law violations at Bank of America. Bank of America unreasonably and negligently relied on internal fourth quarter 2008 forecasts created by Merrill Lynch that omitted any forecast of how the CDOs, CDS, and other toxic assets would perform during the quarter. The former Merrill CFO admitted that this forecast was not, in fact, a valid forecast.

Bank of America knew at the time that the forecast was of questionable validity. However, Bank of America did not do any actual financial analysis to make up for the Merrill omissions. Instead, Bank of America merely pulled a number out of thin air, which was recorded on a forecast as the gut feeling of Neil Cotty, Bank of America's chief accounting officer. Bank of America simply created an assumption that Merrill Lynch's illiquid assets would almost break even for November, thereby spreading October's bad results over 2 months.

The attorneys at Bank of America and at Wachtell, Lipton recklessly did not question this financial information. They advised Bank of America not to make further disclosures to its shareholders based on the deficient forecast and the gut feeling.

Within only weeks, however, reality crowded out wishful thinking. Merrill Lynch's exotic investments continued to lose large amounts of money, causing Merrill to lose over $21 billion in just the fourth quarter. Bank of America went running to the U.S. Government for rescue.

When I asked Ken Lewis about this at our first hearing, he told us that he relied on advice of counsel. Protecting shareholders is often, in the final instance, the responsibility of corporate general counsels and their outside counsel. The subcommittee's investigative findings demand the question, where were the lawyers? Where were the lawyers?

The glaring omissions and inaccurate financial data in the critical November 12th forecasts were so obvious that they should have alerted the attorneys to the necessity of reasonable investigation before making a key decision on Bank of America's legal duties to disclose. The apparent fact that they did not mount such an investigation makes the decision not to disclose Merrill's losses to shareholders an egregious violation of securities laws.

The stage for these possible violations was set by former SEC Chairman Christopher Cox. At exactly the time that CDOs, CDSs, and other exotic instruments proliferated in financial markets, Chairman Cox discouraged formal investigations of, and large corporate penalties against, securities fraudsters. Bank of America's conduct was the corporate reaction to years of weakening enforcement at the SEC under Chairman Cox. Chairman Schapiro has made efforts to turn enforcement policy around.

While I applaud the SEC for enforcing the law, in the case of the nondisclosure of the Merrill bonuses, Bank of America's failure to disclose accelerating losses at Merrill Lynch before the shareholder vote is more significant. Indeed, those undisclosed losses dwarf the amount of undisclosed bonuses. The reliance on counsel defense asserted by Ken Lewis raises the broader question will the Securities and Exchange Commission allow corporate management to rely on the advice of counsel defense and then allow the counsel to avoid liability for their advice? The investing public and now this Congressman wants to know, where is the SEC? As of yet, we don't know.

Thank you.

[The prepared statement of Hon. Dennis J. Kucinich follows:]

Opening Statement
of
Dennis J. Kucinich
Chairman, Domestic Policy Subcommittee
Oversight and Government Reform Committee
December 11, 2009

On December 5, 2008, the shareholders of Bank of America voted to approve a merger with Merrill Lynch. Only twelve days later, Ken Lewis, CEO of Bank of America, made a call to then-Secretary of Treasury Hank Paulson, initiating a process that led to a $20 billion bailout of the merger and a promise of government insurance for losses of up to $118 billion. The chronology of events strained belief. Was it true that the financial situation at Merrill Lynch shifted so dramatically in that short amount of time, as Ken Lewis said? Or did top management know, or should they have known, about the deteriorating situation at Merrill Lynch much earlier? Did they fail to make necessary disclosures to the shareholders?

In the course of this investigation, we discovered that top officials at the Federal Reserve had come to the conclusion that Bank of America knew or should have known in mid-November about the mounting losses that ultimately led them to appeal to the U.S. Government for a rescue. In fact, the top lawyer at the Fed speculated in email to Chairman Bernanke that Bank of America may be liable for securities law violations as a result of not disclosing that information to shareholders.

After reviewing over 400,000 pages of documents and interviewing the key players at Bank of America, Merrill Lynch and the law firm of Wachtell, Lipton, Rosen & Katz, we have found evidence of possible securities law violations at Bank of America:

- Bank of America relied on the November 12 forecast for Fourth Quarter '08, created by Merrill Lynch, that, <u>omitted any forecast</u> of how collateralized debt obligations, subprime mortgage backed securities, credit default swaps – would perform in the quarter.

- The former Merrill CFO admitted to staff that the November 12 forecast was not, in fact, a valid forecast.

- Bank of America knew at the time that the November 12 forecast was of "questionable validity."

- However, Bank of America did not do any actual financial analysis to make up for the Merrill omissions. Instead, Bank of America merely pulled a number out of thin air on November 13, which was recorded on the forecast document as the "gut" feeling of Neil Cotty, Bank of America's Chief Accounting Officer. Bank of America simply created an assumption that Merrill Lynch' illiquid assets would almost break even for November, thereby spreading October's bad results over two months.

- The attorneys at Bank of America and at Wachtell, Lipton did not question the financial information they were given, in spite of the glaring and obvious omission and the explicit reference to a "gut" feeling. They advised Bank of America not to make further disclosures to its shareholders in advance of the merger vote, based on the information in the deficient forecast and a "gut" feeling.

Within only weeks, however, reality crowded out wishful thinking. Merrill Lynch's exotic investments continued to lose large amounts of money, causing Merrill to lose over $21 billion in just the Fourth Quarter. Bank of America went running to the U.S. Government for a rescue.

When I asked Ken Lewis, Bank of America's CEO, about why he had not disclosed the mounting losses to shareholders before the shareholder vote, he told this Committee that he relied on the advice of counsel. Protecting shareholders is often, in the final instance, the practical responsibility of corporate General Counsels and their outside counsel. The Subcommittee's investigative findings demand the question, "Where were the lawyers?" The glaring omissions and inaccurate financial data in the critical November 12 Forecast make Bank of America's decision not to disclose to shareholders unsupportable. Furthermore, the flaws in the forecast document were so obvious that they should have alerted the attorneys to the necessity of a reasonable investigation before making a decision on Bank of America's legal duties to disclose. The apparent fact that they did not mount such an investigation makes the decision not to disclose Merrill's losses to shareholders an egregious violation of securities laws.

As a law enforcement matter, the Subcommittee's findings form the basis of three possible legal violations.

First, a violation of Section 11 of the 1933 Securities Act, which creates private civil liabilities for false registration statements. Here, the question is, did Ken Lewis, Joe Price, Tim Mayopoulous and the Wachtell, Lipton attorneys *reasonably* rely upon the Neil Cotty guesswork and the deficient Merrill Lynch forecast?

Second, a violation of Rule 14a-9 of the 1934 Exchange Act. Rule 14a-9 prohibits false or misleading proxy solicitations. Here the question is, were Lewis, Price, and Mayopoulos *negligent,* and were the attorneys at Wachtell, Lipton *reckless*, in relying upon Merrill Lynch's deficient forecast and Cotty's guesswork?

Third, a violation of Rule 10b-5 of the 1934 Act, which makes it unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." Here the question is, were Bank of America and their attorneys *reckless*, i.e., did their conduct constitute an extreme departure from, or disregard for ordinary care?

The broader question before the SEC is, Will they allow corporate management to rely upon the advice of counsel defense, and then allow the counsel to avoid liability for their advice? This question, in the context of whether a securities fraud was perpetrated when Bank of America failed to disclose information relating to mounting losses at Merrill Lynch before the shareholder vote on the merger, should be central to SEC's enforcement action against Bank of America.

The stage for these possible violations was set by former SEC Chairman Christopher Cox. Bank of America's conduct, potentially illegal conduct, was the culminating corporate reaction to the years of regulatory retrenchment and serious and substantial weakening of enforcement and deterrence at SEC under Chairman Cox.

In 2006, Chairman Cox initiated a policy, known as the corporate penalty Pilot Program, that required enforcement staff to pre-clear proposed corporate penalties with the Commission. The resulting delays, and the concerted action of the Commission to reduce proposed penalties, had the effect of reducing significantly the amount of penalties ordered by SEC. GAO recently found that the tumble in penalties accelerated 39 percent in 2006, another 48 percent in 2007, and then 49 percent in 2008. So at exactly the time that CDOs, CDS, and other exotic investments proliferated in financial markets, Cox's SEC was reducing investigations and penalties for financial fraud. It might as well have been financial regulation according to Cole Porter's 1936 song, "Anything Goes." "The world has gone mad today/ And good's bad today/ And black's white today/ And day's night today." Under Cox's watch, according to GAO, "it became more difficult [for SEC enforcement staff] to obtain 'formal orders of investigation,' which allow issuance of subpoenas to compel testimony and produce books, records, and other documents. Since fiscal year 2005, the number of formal orders approved by the Commission has decreased 14 percent."[1]

Against that record of scandalous performance, current Chairman Schapiro's efforts signal an important turn around. For instance, Chairman Schapiro rescinded the Cox policy of discouraging penalties and formal orders for investigation upon taking office. Chairman Shapiro appointed Robert Khuzami to reinvigorate enforcement at SEC. Nevertheless, Judge Jed Rakoff was unimpressed. In September of this year, he struck down a settlement of charges that Bank of America made false and misleading statements to shareholders regarding $5.8 billion in bonuses awarded by Merrill Lynch after the shareholder vote. Though SEC is now litigating, I am concerned that a pernicious aspect of the Cox legacy may have survived: The unwillingness to pursue, as GAO wrote, "more complicated cases, those based on novel legal reasoning, or those with industry

[1] Government Accountability Office, "Securities and Exchange Commission: Greater Attention Needed to Enhance Communication and Utilization of Resources in the Division of Enforcement," GAO-09-358 at 7 (Mar. 2009).

wide implications, in favor of those seen as more routine."[2] While I applaud the SEC for enforcing the law in the case of the non-disclosure of the Merrill bonuses, Bank of America's failure to disclose accelerating losses at Merrill Lynch to shareholders before their vote on December 5 is more significant. Indeed, the magnitude of the undisclosed losses dwarfs the undisclosed bonuses on which the SEC has thus far focused.

Over the many months of this investigation, we have provided our findings to SEC. The investing public, and now this Congressman, want to know, where is the SEC in pursuing egregious disclosure violations involving billions of rapidly growing trading losses?

###

[2] *Id.* at 42.

Chairman TOWNS. Thank the gentleman for his statement.

I now yield 5 minutes to the ranking member of the Domestic Policy Subcommittee, Mr. Jordan, from the State of Ohio.

Mr. JORDAN. Thank you, Mr. Chairman, and I want to thank you for holding today's hearing. I look forward to exploring the role of the SEC and FDIC in the merger between Bank of America and Merrill Lynch.

This committee's investigation has revealed important evidence of the abuse of power by the Federal Government in response to the financial crisis. As I have said before, Mr. Chairman, while the actions of the government officials took place in a time of significant economic challenges and uncertainty, there must be limits to government action even in a time of crisis, and those limits must be respected.

We must also keep in mind that the actions of government officials in this merger occurred after many of the Nation's banks were forced to accept taxpayer money through the TARP program. We know that in October 2008—this is from testimony Ken Lewis gave us at the very first hearing we had on this issue. We know at that October 2008, meeting, Mr. Paulson, Mr. Bernanke, Mr. Geithner, and Ms. Bair brought the CEOs of the largest private banks in America to the Treasury Department, demanded that they accept the partial nationalization of their banks in exchange for an amount of money of the government's choosing. I look forward to learning more about Mrs. Bair's role in that meeting and this entire affair.

This investigation has continued to reveal the unintended consequences and negative implications of the government's unprecedented intervention in the private sector. I hope the Congress will apply these lessons as we continue to debate the appropriate regulatory framework for our financial system as we move forward.

And with that, Mr. Chairman, I thank you and yield back.

Chairman TOWNS. Thank you very much.

We now move to our witness. We have with us today the Chair of the Federal Deposit Insurance Corporation.

Madam Chair, it is the longstanding tradition that we swear all of our witnesses in. If you would stand and raise your right hand.

[Witness sworn.]

Chairman TOWNS. Let the record reflect that the witness answered in the affirmative. You may begin with your testimony.

STATEMENT OF SHEILA C. BAIR, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. BAIR. Thank you, Chairman Towns, Chairman Kucinich, Ranking Members Issa and Jordan, and members of the committee.

As requested by the committee, my testimony today will focus on the FDIC's role and the decision——

Chairman TOWNS. Madam Chair, you want to pull that mic down just a little bit there?

Ms. BAIR. Sure. As requested by the committee——

Chairman TOWNS. And closer, too, I think.

Ms. BAIR. As requested by the committee, my testimony today will focus on the FDIC's role and the decision to provide assistance to Bank of America.

Let me note at the outset that Bank of America is an open institution, and the FDIC is very sensitive about any discussion of the condition of open and operating insured depository institutions.

In mid-September 2008, in the wake of Lehman's failure, BofA announced that it would acquire Merrill Lynch. BofA's acquisition of Merrill Lynch was approved by the Federal Reserve on November 26, 2008, and was to be finalized in early 2009. However, on or very shortly before December 21, 2008, the FDIC was told by the Federal Reserve and Treasury that BofA had expressed reservations about completing the acquisition of Merrill Lynch. Over the course of time, it was clear that officials from the Federal Reserve and Treasury believed that systemic risk would exist absent an agreement by the government to provide assistance to BofA.

On January 14, 2009, the FDIC received from the Federal Reserve a draft terms sheet describing an assistance package, the principal elements of which were capital infusion in a transaction where the FDIC, Treasury, and Federal Reserve would share in a guarantee against certain losses, otherwise known as a, "ring fence," transaction.

The FDIC continued to analyze where and how much the exposures were and how that specifically impacted the FDIC. The FDIC's board ultimately was persuaded that BofA's condition presented a systemic risk and that the ring fence transaction would mitigate that risk and the risks to the deposit insurance fund in a cost-effective manner.

The transaction also limited the FDIC's risk to a small portion of the covered exposures, recognizing the fact that most of the exposures resided within the investment bank and not the insured depository institution.

On January 16, 2009, the planned Treasury capital infusion and the Treasury-Fed-FDIC ring fence transaction were announced. In early May 2009, BofA asked that the ring fence transaction not be completed.

Moving forward, we have worked continuously with Congress, the Treasury, and the financial regulators toward creating a more resilient, transparent, and better-regulated financial system, one that combines stronger and more effective regulation with market discipline. One of the lessons we have learned over the past few years is that regulation alone is not enough. We need to establish an effective and credible resolution mechanism to ensure that market players will actively monitor and keep a firm handle on risk taking.

We commend you and your colleagues on the progress you have made in moving toward providing the regulators with the tools to effectively deal with any future crisis.

Thank you, and I will be pleased to take any of your questions.

[The prepared statement of Ms. Bair follows:]

EMBARGOED UNTIL DELIVERY

STATEMENT OF

SHEILA C. BAIR
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

BANK OF AMERICA ACQUISITION OF MERRILL LYNCH

before the

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
and the
SUBCOMMITTEE ON DOMESTIC POLICY
HOUSE OF REPRESENTATIVES

December 11, 2009
Room 2154 Rayburn House Office Building

Thank you Chairman Towns, Chairman Kucinich, Ranking Members Issa and Jordan, and members of the Committee. I appreciate the Committee's interest in the role of the Federal Deposit Insurance Corporation in the measures being taken to address the challenges facing the economy and the financial industry.

As you know, just over one year ago, we faced an historic liquidity crisis in global financial markets that shook the confidence of the financial systems in the United States and around the globe. Markets were under extraordinary stress and exceptional measures were taken in an effort to stabilize the economy. Included in those measures were steps taken to provide capital and liquidity to our nation's financial institutions. I believe that these measures have largely accomplished their objectives and have remedied many of the immediate problems associated with the financial crisis.

As requested by the Committee, my testimony today will focus on the FDIC's role in the decision to provide assistance to Bank of America. Let me note at the outset that Bank of America is an open institution and the FDIC is very sensitive, as I am sure the Committee is, about any discussion of the condition of open and operating insured depository institutions.

Background

The FDIC has the statutory responsibility to oversee the national deposit insurance system. As part of this responsibility, the FDIC is responsible for resolving all failures of insured financial institutions. The FDIC also serves as primary federal supervisor for approximately 5,000 state-chartered banks that are not members of the Federal Reserve System. Since the creation of the FDIC during the Great Depression, deposit insurance has played a crucial role in maintaining the stability of the banking system. By protecting deposits, the FDIC ensures the security of the most important source of funding available to insured depository institutions -- funds that can be lent to businesses and consumers to support and promote economic activity.

In the event of a bank failure, the FDIC must determine which resolution strategy will be used. The decision for each failed institution must be in keeping with the least-cost provisions in our operating statute, the Federal Deposit Insurance Act. The Act further includes provisions to authorize action by the Federal government in circumstances involving systemic risk. Specifically, it permits the FDIC to take action or provide assistance as necessary to avoid or mitigate the effects of a perceived systemic risk. In order for this to occur, the Act requires that there be a finding of systemic risk by the FDIC's Board of Directors, concurrence of the Board of Governors of the Federal Reserve System and a subsequent determination of systemic risk by the Secretary of the Treasury, following consultation with the President.

Bank of America

As deposit insurer for Bank of America NA ("Bank of America") and the other insured depository institutions owned by Bank of America Corporation ("BOA") and Merrill Lynch & Co., Inc. ("Merrill Lynch"), the FDIC has a continuing stake in the financial well-being of those insured depository institutions. The FDIC is not the primary federal regulator for bank holding companies or for most of the largest banks, including Bank of America. We rely heavily on the judgment and observations of the primary federal regulator at the largest financial institutions. However, because of our role as deposit insurer, we maintain an examiner presence -- albeit limited -- at the largest banks, such as Bank of America.

In mid-September 2008, in the wake of Lehman's failure, BOA had announced that it would acquire Merrill Lynch. That acquisition was scheduled to close at the beginning of 2009. BOA's acquisition of Merrill Lynch was approved by the Federal Reserve on November 26, 2008.[1]

On or very shortly before December 21, 2008, the FDIC was told by the Federal Reserve and Treasury that BOA had expressed reservations about completing the acquisition of Merrill Lynch. The FDIC was told that some form of assistance might be necessary. Over the next three and a half weeks, examiners from the Federal Reserve, OCC, and FDIC worked to learn more about the type of assistance that might be required and the pool of assets that BOA suggested might be included in a transaction where the FDIC, Treasury and Federal Reserve would share in a guarantee against certain losses ("ring fence" transaction). Based upon the information that was made available, the FDIC continued to raise questions about whether any assistance was necessary. The FDIC made no commitment to provide assistance to BOA at that time.

On January 9, I participated in a conversation with Secretary Paulson, Chairman Bernanke, and several other regulatory staff in which BOA's financial condition was discussed. Secretary Paulson indicated that providing assistance to BOA in a form similar to what had been provided to Citigroup -- capital assistance and asset guarantees -- had been discussed, and that he hoped the FDIC would participate in providing such assistance. We continued to gather information about whether any assistance was necessary. We also asked for additional information about BOA's liquidity and about other risks if no assistance was provided, and about the risks that would be incurred if the FDIC participated in this assistance package. The FDIC also requested more detailed information on where the exposures resided -- were the exposures in the insured depository institutions and funded with insured deposits, or were these derivative exposures that were created and housed within the non-depository investment bank? This distinction -- that there would be relatively small exposures in the insured depository institutions and large in the investment bank -- was important if the FDIC was to consider

[1] Merrill Lynch was an investment bank, regulated by the Securities and Exchange Commission, which had two insured depository institutions: a thrift which was regulated by the Office of Thrift Supervision and an Industrial Loan Company for which the FDIC was the primary federal regulator.

any role in a possible transaction. The FDIC continued to refrain from a commitment of assistance to BOA.

Discussion, review and information gathering, as well as consideration of other options, continued for several days. It was clear that officials from the Federal Reserve and Treasury believed that systemic risk would exist absent an agreement by the government to provide assistance to BOA.

On January 14, 2009, the FDIC received from the Federal Reserve a draft Term Sheet describing the assistance package, the principal elements of which were a capital infusion and a ring fence transaction. We were told that the Term Sheet had previously been sent to Treasury and BOA. There were further intense discussions about the terms and the risks of providing this assistance and of not providing this assistance. The final Term Sheet included provisions addressing executive compensation and common stock dividends. The FDIC's exposure was limited to $2.5 billion, to coincide with the proportion of exposures covered under the ring fence that resided within the insured depository institutions. In compensation for the guarantee, the FDIC was to receive $1 billion in BOA preferred stock with an 8 percent dividend rate and certain warrants.

The FDIC's Board ultimately was persuaded that BOA's condition presented a systemic risk, and that the ring fence transaction would mitigate that risk -- and the risk to the Deposit Insurance Fund -- in a cost effective manner. The transaction also limited the FDIC's risk to a small portion of the covered exposures, in recognition of the fact that most of the exposures resided within the investment bank and not the insured depository institution. Thus, on January 15, 2009 the FDIC's Board of Directors unanimously voted to authorize advising the Secretary of the Treasury that we recommend that he make a systemic risk determination regarding BOA. The FDIC's Board also authorized FDIC participation in the ring fence transaction, subject to the Secretary making a systemic risk determination.

Prior to the FDIC Board's vote on January 15, we were advised that the Board of Governors of the Federal Reserve System had voted to make a systemic risk recommendation to the Secretary, and we were advised that the Secretary expected to make a systemic risk determination after receipt of the recommendations from the FDIC and Federal Reserve, and after consultation with the President.

On January 16, 2009, the planned capital infusion and ring fence transaction were announced. On the same day Treasury purchased $20 billion of BOA preferred stock.

Work to precisely define the exposures to be included in the ring fence transaction -- and to assure ourselves that the value of the BOA preferred stock the FDIC and Treasury were to receive as compensation for our participation in the ring fence transaction at least equaled the economic value of the risk we were to assume -- had been started before January 16, and it continued well into the spring. However, in early May 2009 BOA asked that the ring fence transaction not be completed. In late summer, an agreement was reached to terminate efforts to complete the ring fence transaction. BOA agreed to pay $425 million as a termination fee of which $92 million was paid to the FDIC.

Moving Forward

In the aftermath, the FDIC has worked continuously with Congress, the Treasury and the financial regulators to make sure we have a more resilient, transparent, and better regulated financial system -- one that combines stronger and more effective regulation with market discipline. We commend the House of Representatives -- and the Financial Services Committee -- in moving towards providing the regulators with the tools to effectively deal with any future crises.

I would be pleased to answer any questions from the Committee.

Chairman TOWNS. Thank you very much for your statement.

Let me just state to the Members we are going to be really tight on the 5 minutes today. Because 5 minutes really means 5 minutes, which means 5 minutes to ask the questions and for the person to answer the questions. Because I promised the chairperson that I would have her out by no later than 11:15, 11:20. So we want to respect that and try to move forward.

Let me just sort of ask one quick question. Are there steps you think the Congress can take to avoid future bailouts of the banking industry?

Ms. BAIR. Yes. I think we have put a very high priority on a robust resolution mechanism. We have that for insured depository institutions. And when smaller institutions start to fail, they are put into a very severe resolution mechanism that requires shareholders and unsecured creditors to take a loss, generally a complete loss.

For nonbank entities or activities outside of banks, this resolution authority does not apply and, we think, something very similar to the FDIC process, which is shareholders and creditors take losses, not the government, is very important. And we think that the House bill that is being on the floor now moves very well in that direction, and we think they should be very clear and that the resolution authority should specifically ban assistance to individual institutions going forward. And I believe that is also in the House bill.

Chairman TOWNS. Thank you very much.

I now yield to the gentleman from California, ranking member, Congressman Issa. Thank you very much, Madam Chair.

Mr. ISSA. Actually, Mr. Flake wanted to be recognized first.

Chairman TOWNS. The gentleman from Arizona. He yields to the gentleman from Arizona. Congressman Flake.

Mr. FLAKE. I yield to the gentleman from California.

Mr. ISSA. The gentleman is yielding me his time in order to be expeditious.

Madam Chair, I want to be brief, also; and I have just a series of short questions.

First of all, from the standpoint of the FDIC looking back now, wasn't—forgetting about whether the merger was a good merger, the MAC, all the other things that this committee has worked on, wasn't the underpinning of the additional money, preferred stock as a form of loan, wasn't that in fact the most appropriate thing for the FDIC to approve of so that the capital worth of Bank of America would be undeniable?

Ms. BAIR. Well, I think it is always hard in hindsight to answer questions like that.

Mr. ISSA. Actually, I normally find it easier in hindsight.

Ms. BAIR. It may be easier in hindsight. I guess it is easier to reevaluate decisions that were made.

I think the distinction needs to be made between the insured depository institution that had a strong capital position with other activities that were going on in the bank holding company. And so I think if you are looking just to the insured depository institution where we had the exposure, there is a question about whether additional capital was needed. I do think——

Mr. ISSA. I am not saying whether it was needed. It is clear that—in hindsight, it is clear they didn't need it, because they paid it back to you essentially without it being from actual new money in any large amount. They passed the stress test. And they passed the stress test and said they could pay it back. So I know that part of hindsight is clear.

Ms. BAIR. Right, right.

Mr. ISSA. But the real benefit of the $45 billion of loan, and I repeat it was not—it is not—you know, we didn't bail them out. We didn't give them anything. We bought stock. We bought the worth of the company, and we got interest guarantee and the ability to get our money out ahead of everyone else. Preferred stock is not all bad.

But the effectiveness of it was to, if you will, overcapitalize the company in hindsight. But wasn't that essentially a good thing in that, if there was no other benefit to TARP, the confidence of knowing that these companies, particular banks, were extremely well capitalized, not as to the stockholders but as to the depositors, wasn't that effectively the good thing that came out of this arrangement?

Ms. BAIR. Well, I think, yes, the capital investment certainly created a fortress balance sheet. I think that was the original intention of all these capital investments under TARP.

Again, we were not—the only role that we had was on the ring fence, not on the TARP investment. That was a Treasury program and Treasury decision.

But yes, certainly——

Mr. ISSA. But you were the beneficiary of it in a sense.

Ms. BAIR [continuing]. Is absolutely going to have a stabilizing impact, yes.

Mr. ISSA. The next question is a harder one.

Ms. BAIR. Uh-huh.

Mr. ISSA. Many nonbanks decided to become banks conveniently in this crisis.

Ms. BAIR. Right, right.

Mr. ISSA. Many entities in fact fled to the FDIC. And the FDIC finds itself with its funds, funds which are designed to ensure that we never have to actually put in taxpayer dollars, those funds are stressed right now. Going forward, do you believe that in fact in the future people should be able to run to the FDIC, run to being a bank when it suits them, even if they hadn't been when it didn't suit them?

Ms. BAIR. No, I don't think they should be able to do that.

Mr. ISSA. Is that a reform that you presently see on the horizon that would give you that ability next time to say you better be there early or not come at all?

Ms. BAIR. Well, I think—two things. I think we need a robust resolution mechanism so when entities get themselves in trouble they don't get government assistance. They get put into receivership. And I think entities asking for assistance maybe won't ask for assistance so much if they know that is the repercussion.

In terms of entities becoming bank holding companies and having insured depository institutions not just for deposit insurance but for the Fed lending facilities, we have suggested that there needs to be a systemic risk council that would decide and have the power to say to an entity that became a bank holding company but perhaps later doesn't want all the regulation that entails that they still need to subject themselves and be subject to prudential supervision, that they can't arbitrage just becoming a bank holding company when it suits them and then not and escaping the regulation when that suits them.

Mr. ISSA. Thank you. I yield back to the gentleman from Arizona, and he yields back.

Mr. FLAKE. I yield back.

Chairman TOWNS. Thank you very much.

I now recognize the ranking member—I am sorry—the chairman of the Domestic Policy Subcommittee, yes, Mr. Kucinich from Ohio.

Mr. KUCINICH. Chairman Bair, do you have any concerns that America may face yet another bank collapse?

Ms. BAIR. No, I don't, but I think there is a lot of work that needs to be done to continue the stabilization and the cleanup, and I think the regulatory reform efforts going on right now in Congress are absolutely crucial to that.

Mr. KUCINICH. Do you think banks that are too big to fail are too big to exist and ought to be broken up?

Ms. BAIR. Well, I think there needs—the problem with too big to fail is the same problem that you had with Fannie and Freddie. There is an implied government backstop, which feeds into risk taking. If shareholders and creditors think they have the upside and the government has the downside, that is going to encourage risk taking. We think that is a major factor that drove the crisis.

And again, this is why—I hate to sound like a Johnny One Note, but we really need—Congress needs to establish a very robust, very severe resolution mechanism that tells shareholders and creditors they will take losses if these institutions go down. Right now, they are just happily, you know, feeding, extending credit, and making equity investments, and I fear that they are not really doing their own due diligence in terms of looking at what is going on in these very large institutions. Do they understand the risks? Do they understand—is the management on top of those risks? I don't think we have market discipline right now, and we need that.

Mr. KUCINICH. Do you have any concern that banks may still be overleveraging derivative markets?

Ms. BAIR. Absolutely. Yes. I would say financial institutions, not——

Mr. KUCINICH. Pardon.

Ms. BAIR. I think banks as loosely used. I would say financial institutions, I absolutely have that concern, yes.

Mr. KUCINICH. And what can you tell the American people about the security of their bank deposits?

Ms. BAIR. Their bank deposits are very secure. That is one thing we have been very early on with a public information campaign. The resolutions have been smooth. Everyone's deposits have been completely protected, as they always have been. So there is no question that the FDIC has resources to deal with whatever may come.

Mr. KUCINICH. Would you tell us what those immediate resources are to assure security of deposits?

Ms. BAIR. Right. Well, we are full faith and credit, and we have a Treasury line and a congressional commitment to back insured deposits. And, again, that has been in effect for 75 years. Right now, we have required prepayment of assessments that is going to bring in another $45 billion at the end of the year, which will bring our cash position probably in the first quarter to around $60 billion, given what we already have and additional moneys that we are going to be bringing in. So I think it is a very strong cash position. We can borrow up to $500 billion from the Treasury Department if we would need to do that. I don't foresee any circumstance where that would become necessary.

Mr. KUCINICH. Thank you, Madam Chair.

Thank you, Mr. Chairman. Yield back.

Chairman TOWNS. Thank you very much.

I now yield to the ranking member of the full committee, Congressman Issa.

Mr. ISSA. Thank you, and I will be equally brief this time.

Madam Chair, you on January 9th determined it was clear "It was clear that officials from the Federal Reserve and Treasury believed the systemic risk would exist absent an agreement by the government to provide assistance to BofA."

That is really the point at which you came in. But isn't it true that the deal was already done prior to that time to give them the money? Isn't that what we have essentially discovered?

Ms. BAIR. Right. Well, I will tell you I know conversations already occurred between the Treasury and the Fed and Mr. Lewis prior to the time we were contacted. I wasn't privy to those conversations, so I don't know.

Mr. ISSA. Sure. I realize we have been very unfair to you in that you came in on the tail end of everything.

Ms. BAIR. Yes, I did.

Mr. ISSA. And only if something was a bank or about to become a bank holding company.

Ms. BAIR. Right.

Mr. ISSA. Let me followup with this question.

Specifically in your role as FDIC Chair, if you had a choice and you were told, what would you like to do when BofA said we are going to invoke the MAC or give us more money? It doesn't matter who said it, but that occurred. Wouldn't the FDIC's position in the future be go to Congress or go to the TARP and bail out Merrill Lynch directly? If they don't want it and there is money needed, and obviously there wasn't new management or consolidation in the merger at all, wasn't it really go bail out Merrill Lynch, do whatever you are going to do with Merrill Lynch, they are not a bank, and why should it be clouded with me? Isn't that essentially the—you and future Chairs' position that you would prefer?

Ms. BAIR. Well, we think it is important to act as one government, yes. But my first job and foremost job is to protect insured depositors. And I can't, with at that time about a $50 billion deposit insurance fund, bail out the entire economy and everybody else with the resources that we have. And I have to make sure that we have credibility to protect insured depositors, first and foremost.

So, yes, investment banks are not insured depository institutions, and it would have been nice to have other mechanisms available. Absolutely.

Mr. ISSA. So as we are Monday morning quarterbacking up here, if there is anything—and since we have determined that Chrysler and General Motors qualified for TARP money, if there was any mistake made, it was this very lucrative merger that BofA is now happy about and touting, to be honest, when faced with the dilemma, it was a Merrill Lynch decision. Treasury, Paulson, Geithner, they should have made a Merrill Lynch decision relative to. Instead, what they do is they pushed it onto a bank holding company, and a bank holding company then had a systemic risk problem which fell to your doorstep, and $45 billion of taxpayer money, albeit paid back, in fact was put in play.

Ms. BAIR. Well, yes, BofA was already a bank holding company, obviously. This is a situation where Merrill Lynch was not. So through the acquisition it got folded into the bank holding company structure. And, yes, there were significant benefits that accrued because of that, yes.

Mr. ISSA. Now on a lighter note——

Ms. BAIR. OK.

Mr. ISSA [continuing]. Yesterday this committee on a bipartisanship basis moved for a common searchable platform, although not XBRL, which of course you use. We mandated a common uniform platform with rigorous structures so that there could be transparency either to those cleared or, in the case of assets, information available normally to the public, directly to the public. What is your experience and what would you guide us with, in your case, XBRL and that kind of capability that it gives you to look down and, if possible, even allow others to look down?

Ms. BAIR. Right. Well, IT is not my forte. We have been leaders in this area. I think we have had a very good experience, and I would certainly offer our IT people to give you a more detailed briefing on that, if you would like.

Mr. ISSA. Let me—last followup question, and I will yield back. Do you believe that this committee is on the right track when we insist that data bases be common, robust, searchable, and interactive so that in fact, when appropriate, the American people can have transparency?

Ms. BAIR. Right. You may get me in trouble with other agencies, but if I could just follow that, we have had a very positive experience, and I would encourage others and this committee to facilitate broader use.

Mr. ISSA. Thank you, Madam Chair. I yield back.

Chairman TOWNS. Thank the gentleman from California.

I now yield to the gentleman from Maryland, Congressman Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman; and, Ms. Bair, welcome, and thank you doing such a superb job.

I recognize that the FDIC's job in the Bank of America bailout was different from that of your fellow regulators at Treasury and the Federal Reserve. But, nonetheless, we have a responsibility to explore all aspects of this tainted transaction.

In your written testimony, you note that the FDIC was notified of potential government assistance in the Bank of America-Merrill Lynch merger around December 21, 2008. You go on to say that over the next 3 weeks the discussion continued about Bank of America's financial condition and the nature of the assistance to be provided. You discussed the case with Secretary Paulson, Chairman Bernanke, and others on January 9, 2009, and were provided a draft terms sheet on January 14th. This is all correct, I hope, and I am working from your own written testimony. Is that right?

Ms. BAIR. That is right.

Mr. CUMMINGS. My concern is the fact that in past hearings in this committee we have heard about how Ken Lewis briefed his board of directors on December 22, 2008, and again on December 29, 2008, indicating that at least $12 billion in fourth quarter Merrill Lynch losses would be covered by the Federal Government.

I am not asking you what happened at those meetings. I know you weren't there. But what I would like to address is this. Do you have any reason to believe that Ken Lewis had sufficient basis on the structure of any potential deal to brief his board with such certainty?

Ms. BAIR. No. Again, we weren't privy to any of those discussions, and certainly the FDIC had made no decision at that time about whether we would participate and to what extent we would and how that would take place or whether it was necessary.

Mr. CUMMINGS. Based on your testimony, the government regulators were still reviewing the Bank of America positions and working on whether a deal would occur well into the new year. It certainly doesn't sound like it was a done deal, does it?

Ms. BAIR. No. And, again, I can't—we were only one small piece of this. But certainly from the FDIC's perspective we had committed to continue talking with the Fed and Treasury and examine the facts and analyze to what extent assistance would be appropriate. We had not made any decisions during that time period, no.

Mr. CUMMINGS. This is not you saying this. This is me saying this. One could certainly read this as Mr. Lewis pulling a fast one on his board to get them to approve the deal. Unless you want to comment.

Ms. BAIR. I think I will stay away from that.

Mr. CUMMINGS. I am sorry?

Ms. BAIR. I think I will stay away from that. Thank you.

Mr. CUMMINGS. Thank you very much.

Thank you, Mr. Chairman. I yield back.

Chairman TOWNS. Thank you very much. I thank the gentleman from Maryland for his questions.

Now yield to the ranking member of the committee, Mr. Jordan of Ohio.

Mr. JORDAN. Thank you, Mr. Chairman.

Chairwoman Bair, let me—I have looked at your record, and you were a professor of regulatory policy, and—very impressive—and I am just curious, on a broad context are you, like I am, a bit troubled—frankly, for me, it is more than a bit—troubled by this what I have called unprecedented involvement by the government in the private sector?

Whether we are talking President of the United States deciding who gets to be CEO of General Motors, whether we are talking about the fact that we now have in the United States of America something I thought I would never see but a Federal Government pay czar telling private American citizens how much money they can make, and bailouts, and TARP, and second stimulus coming in, on and on it goes. So just as an accomplished professional individual, are you nervous about this general direction and, again, this unprecedented involvement of the government in the private marketplace?

Ms. BAIR. Absolutely. And we think better tools are needed for the government to deal with this in different ways going forward.

We are very much opposed to—and I believe the House bill does this, prohibits capital investments in banks and financial institutions going forward. I think government ownership of financial institutions has created not only a lot of public outcry and cynicism but also very difficult issues about what should be private entities and private sector decisions, based, obviously, on some prudential regulatory standards. But government ownership has created a whole list of problems, and we would like to end that going forward.

Mr. JORDAN. OK. With that being said, let me take you back—and this, again, as I pointed out in my opening statement, was brought out when we first had Ken Lewis in front of this committee several months ago. The meeting that took place here in D.C. with the nine largest banks 10 days after the TARP legislation was passed—and, again, the TARP legislation was passed designed to go in and get these troubled assets off the books, free up credit, straighten up these balance sheets, et cetera.

Ten days later, the nine biggest banks were brought to the Nation's Capital. According to Mr. Lewis' testimony, Mr. Paulson and Mr. Bernanke and you were in that meeting; and Mr. Lewis indicated he had no idea what the meeting was about. That the meeting went with a piece of paper slid across the table to the banks telling them how much money they were now going to take from the TARP program, whether they asked for it or not, and that they had to sign a statement saying they were in agreement to that.

Is his recollection of that meeting accurate? Is that in fact what took place?

Again, not 10 days after we were told—the Congress of the United States was told that the TARP program, the money that was made available be used for something entirely different.

Ms. BAIR. Right. I was invited to attend that meeting. I was not involved in decisions about who should come to that meeting and who was going to get what. My role was confined to explaining the temporary liquidity guarantee program, the debt guarantee program. The only remarks I made were to explain that program, and I did not opine or comment at all on the capital investments piece. We were not involved in decisionmaking, and we remained silent during that discussion. But, yes, these banks were strongly encouraged to take this money.

Mr. JORDAN. Going back to your answer to my first question, though, were you troubled that day about what you saw taking place in that meeting in light of the fact you just said—you made two statements already today. You said you were troubled by this unprecedented involvement of the government in the private sector; and you also said, in an answer to Mr. Issa's question earlier, that the government should act as one. So were you sitting in that meeting troubled by what you saw taking place in that meeting, again 10 days after the legislation had been passed for an entirely different purpose?

Ms. BAIR. Yes. I think—two things. I think these decisions were made in the fog of war. These decisions had to be made very quickly, and the situation was becoming more and more destabilizing. And, also, there had been an international agreement to use a combination of liquidity guarantees. We were involved in liquidity guarantees and capital investments to stabilize the system.

Frankly, the idea of it took my breath away, and it was quite unprecedented in terms of the private sector system that we have. And so I was concerned, and I have——

Mr. JORDAN. Was that the first time—did you know what was going to take place in that meeting, or did you come into that meeting much like Ken Lewis and the rest of the other——

Ms. BAIR. We were told in advance who was going to come and that they were going to be asked to take—or encouraged to take capital investments. We were absolutely told that in advance.

I did not weigh in one way or the other. I confined my role to explaining the debt guarantee program. I have said in retrospect I wish we had weighed in, because I think, again, government ownership in banks has created a whole host of problems.

And, by the way, on troubled asset relief, I think we still need a program, and we would like to see maybe perhaps Congress authorize that going forward. That still needs to be done and has to be done.

Mr. JORDAN. Mr. Chairman, real quick—I appreciate what you said, Ms. Chairwoman. I think this has been very helpful. If I could just ask one other question, Mr. Chairman.

Chairman TOWNS. Go ahead.

Mr. JORDAN. The talk this week is about using TARP dollars for stimulus, for something outside of the scope.

Ms. BAIR. Right.

Mr. JORDAN. Again, I think it was done already. But I totally disagree with this. Your thoughts, if you would, on the idea of using TARP money for a second stimulus.

Ms. BAIR. Well, I think you are asking me something beyond my pay grade, because I like to confine my public comments to areas where I think appropriately fall within my sphere as chairman of the FDIC.

I do think that there needs to be more focus in terms of troubled asset relief. We still have toxic assets on the books of banks. Particularly the smaller banks really did not benefit from the capital investments. The smaller banks are a large share of small business lending, but their need to continue to work out and reserve against these legacy loans that they have is inhibiting their ability to engage in new lending. So we do think it would be appropriate and consistent with the Troubled Asset Relief Program to try to deal with that problem.

But, beyond that, I would not want to opine about other uses that others might want to make of the TARP money.

Chairman TOWNS. The gentleman's time has expired.

Mr. JORDAN. Thank you, Mr. Chairman.

Chairman TOWNS. I now yield to the gentleman from Virginia, Congressman Connolly.

Mr. CONNOLLY. I thank the chairman.

Welcome, Chairwoman Bair. And I am going to ask you to move your mic closer. I cannot hear you sitting here because of the acoustics in this room.

I am listening to my friend from Ohio, and he loves to use the phrase "this unprecedented Federal intervention in the financial sector", as if we didn't have the worst meltdown in 70 years a year ago September.

Let me ask you, wearing your FDIC hat, as somebody who has an interest in insuring deposits in depository institutions regulated by the Federal Government, so what if we hadn't had that unprecedented Federal intervention by a Republican administration, by the way? What would have happened to the banking sector in America, wearing your FDIC hat.

Ms. BAIR. I think it wasn't pretty. It wasn't perfect. I think retrospect and hindsight always has additional wisdom.

Mr. CONNOLLY. So should we not have done anything?

Ms. BAIR. No, we had to do something, and it did stabilize the system. I absolutely agree with that. Something needed to be done, and that was the decision that was made, and it did stabilize the system.

Mr. CONNOLLY. So intervention was necessary, in your view?

Ms. BAIR. Intervention was absolutely necessary.

Mr. CONNOLLY. Now, the intervention that was designed, this came from some pointy-headed liberal academic from some Ivy League College, right? It didn't come from a Republican Secretary of State and a Republican administration, did it?

Ms. BAIR. I am sorry, what are you referring to?

Mr. CONNOLLY. Who proposed the idea of the TARP?

Ms. BAIR. Oh, the TARP. The TARP was proposed by, yes, the Treasury and the Fed.

Mr. CONNOLLY. Oh. Not a pointy-headed liberal academic from an Ivy League college? By a Republican businessman who was the Republican-appointed Secretary of the Treasury in a Republican administration. Is that correct?

Ms. BAIR. Yes, that is my recollection of how——

Mr. ISSA. If the gentleman would yield?

Mr. CONNOLLY. No, I am not going to yield.

Let me ask you a question. In your testimony you say that you have, wearing your FDIC hat, a direct interest in both Bank of America and Merrill Lynch because they are depository institutions. Is that correct?

Ms. BAIR. That is right. Well, Merrill Lynch is not.

Mr. CONNOLLY. I am sorry?

Ms. BAIR. Bank of America, the bank is an insured depository institution. Merrill Lynch was an investment bank.

Mr. CONNOLLY. I know, but I am reading from your testimony.

Ms. BAIR. Right.

Mr. CONNOLLY. OK. And you assert that FDIC has a continuing stake in the financial well-being of those insured depository institutions.

Ms. BAIR. Right.

Mr. CONNOLLY. OK. So what was the view of the FDIC at the time the Bank of America proposed to acquire Merrill Lynch? Was that a good business decision? Was that a risky business decision? Were you aware of the fact that they had unprecedented losses, by the way, without unprecedented Federal regulatory intervention?

Ms. BAIR. Well, a couple of things. We are not the holding company regulator. The Fed is. And we do not approve mergers and acquisitions. The Fed does. We are also not the primary regulator for Bank of America.

Mr. CONNOLLY. I understand.

Ms. BAIR. We insure them. We have backup supervisory authority. So I think in terms of the more intimate knowledge of that situation would come from the Fed and the OCC.

As backup supervisor, frankly, we must rely on the primary regulator. If there starts to be troubles, then we move in. But without red flags, no. With those caveats, I was not aware until we got these phone calls and started looking into it that Merrill Lynch had such significant losses in the fourth quarter. They were quite profound.

Mr. CONNOLLY. Let me ask you, we have a bill that is pending before the floor of the House of Representatives today that would constitute a major overhaul of regulation and for the first time finally allow some oversight of the risky derivatives market, for example, and would, in effect, extend some Federal oversight and regulation of investment banking by any other name, not many are left, none of which existed previously.

In retrospect, just given your financial expertise, do you think we made a mistake to explicitly exempt derivatives, a multi-trillion dollar market, from any Federal regulation?

Ms. BAIR. Oh, absolutely. That was a mistake. Absolutely.

Mr. CONNOLLY. So, again, this unprecedented Federal intervention in the financial markets, in the case of derivatives, since there is no such unprecedented Federal intervention at the moment, maybe in retrospect we should have had some?

Ms. BAIR. I think we absolutely should have had more regulation in a lot of areas and particularly in OTC derivatives. There is no question in my mind about that.

Mr. CONNOLLY. Thank you.

And my final question, does the FDIC have a point of view with respect to the extension of FDIC that is contained in the bill that is pending before the House today? Is that a good idea to extend the FDIC and finance that extension by having the big banks have an extra fee rather than taxpayers do it?

Ms. BAIR. Right. Yes, we do support. We have said that for banks and bank holding companies that have insured depository institutions we would like to be the resolution authority. For nonbanks, we will let Congress decide that. And I think they have decided they would like one entity doing it all.

And, yes, we think that this should be a very robust resolution mechanism that provides no open bank assistance, no conservatorship, everyone goes into receivership, their shareholders and creditors take losses. That is the process that we use for banks, and that is the process that works.

And so, yes, and we think the working capital needs for this fund should be provided through a risk-based assessment on the larger financial entities. And, again, this could be another lever, another tool to discourage excessive risk taking. So we do support that part of it.

Mr. CONNOLLY. Thank you.

My time is up. Thank you, Mr. Chairman.

Chairman TOWNS. The gentleman's time has expired.

I now yield to the gentleman from Missouri, Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Madam Chairwoman, thank you for being here this morning.

I am just kind of curious, now that we have some nonbanks that are banks and Lehman Brothers has been absorbed by BofA, have you been in to examine that portion of BofA? Have you been in to examine the bank itself? Have you been in to examine like Goldman Sachs and those folks at all since this all took place?

Ms. BAIR. I cannot comment on specific institutions. Let me tell you generally what we are doing, which is, right now, we have backup authority only for insured depository institutions. So activities outside of insured depository institutions like investment banking, even though they might be part of a broader holding company structure, we have no authority there. That is the exclusive domain of the——

Mr. LUETKEMEYER. Goldman Sachs is now a bank, is it not?

Ms. BAIR. No, because the insured depository institution is only a subsidiary of a larger bank holding company structure. This has been a problem for us.

And another positive thing that we think the House bill does is give us backup authority over everything in the holding company. Right now, it is only over the piece that has the deposit insurance, which is not the whole thing.

Mr. LUETKEMEYER. Do you think that there needs to be some ability to regulate and have some oversight over some of these off balance sheet liabilities that a lot of these folks are involved with?

Ms. BAIR. Absolutely. Yes.

Mr. LUETKEMEYER. What are your plans do that?

Ms. BAIR. Well, fortunately, the accountants have done a lot of it already. We are implementing FAS 166 and 167, which basically requires that these off balance sheet exposures now be counted on balance sheet. So you have to hold capital and reserves against them. So we will be finalizing rules next week to make clear that you need to hold capital and reserves from the regulatory capital, that we will treat those as on balance sheet assets.

On the derivatives area, the OTC derivatives area, I think Congress needs to act on that. Because of the Commodity Futures Modernization Act, there is very little authority to provide product regulation or market regulation; and we have been working with the SEC and the CFTC to strengthen that. And we are generally supportive of that.

Mr. LUETKEMEYER. OK. You mentioned a while ago that all our banks are in great shape, yet this last year or two we have had almost a record number of bank failures within a short period of time.

Ms. BAIR. I don't know that I said——

Mr. LUETKEMEYER. How many more failures do you anticipate over the next year or 2 years?

Ms. BAIR. I would not say—I think most banks continue to be profitable and—but there are clearly some under distress. And we do not publicly release our failed bank projections, but it will continue to go up. We think it will peak next year.

Mr. LUETKEMEYER. I understand. OK.

But your comment earlier was also with regards to a lot of small banks are having to absorb some of these—they are part of the ripple effect of some of the big guys here and are certainly under stress at this point. Do you have any plans for some forbearance for those folks to allow them to be able to withstand this and to outlive some of these problems so that they are not going to be closed as a result of some of the actions of some of the big guys?

And while we had forbearance with the big folks and helped them get over this, we don't have TARP funds available for the small guys. And if we don't have forbearance for those folks, they are the ones who are going to suffer disproportionately compared to what the other folks have. And while it may not be a big deal to the folks who are concerned with BofA, it certainly is going to impact a lot of community banks in my district and a lot of small districts around this country.

Ms. BAIR. Well, Congressman, by statute, if a bank becomes insolvent or can no longer meet its liquidity demands, it needs to be closed. There is a very well-defined, prompt corrective action procedure in the statute. We cannot provide open bank assistance unless there is a systemic risk and then only if the Fed and the Treasury and the President agrees. By statute, we cannot provide——

Mr. LUETKEMEYER. With all due respect, Madam Chair, my question, though, is are you going to have some forbearance on those folks because of the unusual circumstances that they find themselves in through no fault of their own, only being a participant in investing in some things that wound up getting them into trouble? And they don't have the opportunity, like you just said, for some of the TARP funds and things like this.

Is there willingness on your part to look at these situations on a case-by-case basis and say, hey, the rest of the bank has been profitable; it has been under good management; just this one area is a problem; and, therefore, we are going to deal with this and work with them on this and not close them down as a result of that? Is there a willingness to look at that situation?

Ms. BAIR. We have done that already, I think. We released and were able to get interagency agreement on some guidelines recently that explicitly allow banks to do loan restructurings with the commercial real estate loans. It needs to be disclosed and well documented and only if you have a creditworthy borrower that continues to make repayments on a restructured loan. We tried do that already.

I guess my only point is, though, Congressman, once the institution no longer becomes viable under the statutory criteria, there is no flexibility to provide forbearance. And I think these rules were put in place after the S&L crisis, where there is forbearance and there is forbearance. And sometimes if forbearance just denies the problem that exists and delays the closing, it will end up costing the government more money, which is what happened during the S&L days. So we do need to be careful.

But, absolutely, for the healthier institutions that can make it, we are trying to give them flexibility to work these loans out.

Mr. LUETKEMEYER. OK. Thank you, Madam Chair. Thank you.

Chairman TOWNS. The gentleman's time has expired.

I now yield 5 minutes to the gentleman from Louisiana, Mr. Cao.

Mr. CAO. Thank you very much, Mr. Chairman; and I would like to continue questioning concerning community banks similar to Mr. Luetkemeyer. Because, in Louisiana, many of the banking systems are community based banks, and they are impacted tremendously by the financial overhaul that we are looking at in the Congress. Madam Chair, can you provide me with the number of banks that have failed in Louisiana?

Ms. BAIR. I do not know that off the top of my head, but I will certainly get it to you this afternoon when I get back to my office.

Mr. CAO. OK. But probably it is either none or extremely few.

Ms. BAIR. I would really need to check. I am sorry, Congressman, but we have had about—I think we will have about 140 failures, and it is very difficult to know State by State. I will get that information back to you very quickly.

Mr. CAO. That is fine.

The community banks in Louisiana, they did not involve themselves in the subprime mortgage mess; and, as such, many of them were profitable in the past years, while some of the big banks have failed. My question to you here is, why are we making these small community banks, who were successful, who operated within the boundaries of the traditional loaning criteria, they followed the rules, why are we making them pay for the faults of the big banks through this tremendous overhaul process?

Ms. BAIR. Well, I think—two things. I think you are right. Community banks generally did not make subprime, they didn't make these high risk mortgages, they did engage in commercial real estate lending. Some of that was not prudent. A lot of it was. They were good loans when they were made, but because of the economy they are going bad now. And as the economic problems continue, more and more of the failures are driven by that.

But, again, banks must hold certain levels of capital and loan loss reserves against their loans. And if their loans are going to have losses that exceed their capital capabilities, they become insolvent. Or if they can't meet their liquidity demands, if depositors want to withdraw money and they can't have enough cash to do that, then they need to be resolved. And that is—again, there is a fairly well-defined procedure in our statutes to do that.

I think this Congress, you know, again back to the conversation about the appropriate use of TARP going forward and troubled asset relief, I think this is a ripe area, especially for smaller banks, to provide some assistance, continued need for troubled asset relief for the smaller institutions. And we would be very strongly supportive. But our statute does not allow us to provide open bank assistance to large or small institutions, again, unless it is under this very narrow systemic risk exception.

Mr. CAO. It seems to me that the small banks are being penalized for the actions of bigger banks.

Ms. BAIR. I am greatly troubled, and I have spoken out about this for a long time, of the different treatment between large and small. And the very large get the TARP money and get the support and the small ones get closed. I don't like that.

Going forward, I would like to close the big ones, too. I mean, I think that is really—if we are going to have a free market system, not a free-for-all system but a free market system, I think going forward the resolution regime needs to be able to work for small and large institutions, and right now it can only work for the smaller ones.

But the immediate problem, you are right. It is not fair, and we have said that TARP needs—we need to figure out a way to make TARP work better for the smaller institutions. And, again, with troubled asset relief, not so much capital investments, I think that is a problem. But troubled asset relief, providing support there to help them get rid of these bad loans so they can make new loans, we are very supportive of that and work with Treasury, work with Congress on trying to make those programs more effective.

Mr. CAO. Can you explain to me—I agree with you that the big bank institutions that were involved in these subprime mortgage loans, we need to have a better mechanism of overseeing their operations. But can you explain to me how regulating these smaller community banks that are already regulated by State law, how would that improve our country's financial health when they have been profitable, when they have been following the traditional methods of loaning? They were not involved or did not contribute to this financial mess? How would regulating them improve our financial health?

Ms. BAIR. First of all, no Louisiana failures. My staff just handed me a note. So no failures in your State.

I think we provide supervision, obviously, of small and large banks because they have deposit insurance. There is a government exposure there. If they get in trouble, we always protect the insured depositors. So with that comes prudential supervision, and that has been the cover for over 75 years.

I think, moving forward, my concern from a supervisory perspective with the smaller banks is helping them diversify their balance sheet. Because of unlevel playing fields between large and small institutions, as well as between insured depositor institutions and the shadow sector, the nonbank sector, community banks have been relegated primarily to commercial real estate lending and small business lending; and they provide good support for their communities in those two areas, but they don't have much diversification. They got the mortgages taken away from them, a lot of the consumer credit taken away from them, and I think a lot of that has been driven through an unlevel regulatory requirement.

So, going forward, I would change that to help them further diversify their balance sheet and get back to where we used to be with community banking, where they were in a position to offer a more full range of services to their communities.

Chairman TOWNS. The gentleman's time has expired.

Let me announce that we have 3 minutes left on the vote, and of course we will return 10 minutes after the last vote. I understand there are three votes.

Madam Chair, let me thank you very much for coming this morning. We will now recess until 10 minutes after the last vote.

The committee is in recess.

[Recess.]

Chairman TOWNS. The committee will reconvene.

Our second witness today is Mr. Robert Khuzami, Director of the Division of Enforcement at the Securities and Exchange Commission. It is committee policy that all witnesses are sworn in. So if you would stand and raise your right hand.

[Witness sworn.]

Chairman TOWNS. You may be seated. Let the record reflect that the witness answered in the affirmative.

Mr. Khuzami, you may begin.

STATEMENT OF ROBERT KHUZAMI, DIRECTOR, DIVISION OF ENFORCEMENT, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. KHUZAMI. Thank you, Chairman Towns, Ranking Member Issa, Congressman Kucinich. My name is Robert Khuzami, and I am the Director of Division of Enforcement at the Securities and Exchange Commission. I became director on March 29th of this year. Thank you for the opportunity to testify on behalf of the SEC regarding Bank of America's acquisition of Merrill Lynch.

The committee's invitation asks about the SEC's litigation against Bank of America. Because the enforcement action is ongoing, discussion of certain aspects of this litigation pose a risk of negatively affecting our case. I am happy, however, to discuss elements of our publicly filed court papers.

The complaint in our case concerns a November 2008, joint proxy statement that Bank of America and Merrill sent to their shareholders soliciting shareholder approval for Bank of America's acquisition of Merrill. The complaint alleges that the proxy statement violated proxy solicitation provisions because it contained material faults and misleading statements.

Specifically, we allege that Bank of America represented in the proxy statement that Merrill had agreed not to pay year-end performance bonuses to its executives prior to the closing of the merger without Bank of America's consent. Bank of America, however, failed to disclose that it already had consented to Merrill's payment of up to $5.8 billion in discretionary year-end and other bonuses to Merrill executives. That complaint alleges Bank of America's omission of the information rendering the proxy statement misleading and false.

At the time we filed our complaint, the Commission submitted a consent judgment for the court's consideration under which Bank of America agreed to settle on terms that included payment of $33 million and the entry of an injunction prohibiting it from further proxy solicitation violations. As you know, the judge declined to approve the settlement, and the litigation is thus ongoing.

The judge's decision has not affected our underlying case, which is set for trial in March of next year. We stand by our charges, and have used the additional discovery available in the litigation to further pursue the facts and to determine whether or not additional claims are appropriate. In determining how to proceed, we will, as always, be guided by what the facts warrant and the law provides.

With regard to the proposed settlement, we believe it was reasonable, appropriate, and in the public interest, and also properly balanced to relevant factors that must be considered when assessing any settlement. Where a corporate issuer fails to meet its statutory obligations, the need for deterrence is paramount. The proposed penalty, which would have been the second largest ever imposed in a proxy statement case, would have sent a clear message that proxy solicitations must include the substance of separate nonpublic documents when the failure to do so results in material misrepresentations or omissions.

It also clearly communicated to shareholders and the public that management had failed to keep the company in compliance with securities laws and undercut the position now asserted by Bank of America that there was no legal requirement to disclose such information.

Importantly, these objectives would have been achieved in a way that did not place an undue burden on shareholders. Although a $33 million penalty is a significant amount, it is not likely to have had a material adverse financial impact on individual innocent shareholders, given the billions of shares of Bank of America stock then outstanding.

You have also asked why our complaint did not charge individuals. The SEC pursued the charges we believe were appropriate based on the investigative record and applicable law. The securities provisions that govern proxy statements are directed to those who solicit proxies or in whose name proxies are solicited. Here, the corporations solicited the proxies. As such, the Bank of America had a legal obligation that we alleged it failed to meet.

To establish that individuals aided and abetted a proxy solicitation violation or committed frauds under the security laws, it is necessary to prove scienter, or knowing or reckless misconduct. Based on the record that existed at that time, we did not believe that we could fairly and properly assert scienter-based charges against individuals under the applicable legal standards. We have followed and will continue to follow any additional evidence developed wherever it leads.

I want to be clear that the proposed settlement in no way reflects a change in the Commission's approach to pursuing charges against individuals who violate the Federal securities laws. The Commission has been and will continue to be aggressive in bringing actions against individuals who violate the securities laws and also will continue to vigorously pursue penalties from culpable individuals, including corporate executives. In fact, as outlined in my written testimony, the Commission recently has filed a number of enforcement actions against corporate executives charging violations of the Federal securities laws and seeking extensive remedies.

Thank you for the opportunity to address these important issues, and I look forward to answering your questions.

[The prepared statement of Mr. Khuzami follows:]

Events Surrounding Bank of America's Acquisition of Merrill Lynch

by Robert Khuzami
Director, Division of Enforcement
U.S. Securities and Exchange Commission

December 11, 2009

Chairman Towns, Ranking Member Issa, Members of the Committee:

Thank you for the opportunity to testify on behalf of the Securities and Exchange Commission regarding the events surrounding the Bank of America Corporation ("Bank of America") acquisition of Merrill Lynch & Co, Inc. ("Merrill") and the Commission's ongoing litigation against Bank of America.

Bank of America's Acquisition of Merrill

The Committee's invitation letter asks whether the SEC was consulted with regard to the January 16, 2009, bailout of Bank of America. I became Director of the Commission's Division of Enforcement on March 29, 2009, after the Merrill acquisition was negotiated and closed. Although I stand ready to assist the Committee in any way I can, I have no knowledge of what consultations, if any, occurred with the Commission, other than what I have read in the press or the testimony of previous Committee witnesses.

SEC's Litigation Against Bank of America

The Committee's invitation letter also asks about the SEC's ongoing litigation against Bank of America. On August 3, 2009, the Commission filed a complaint in the U.S. District Court for the Southern District of New York against Bank of America. The complaint concerns a November 2008 joint proxy statement that Bank of America and Merrill sent to their shareholders soliciting shareholder approval for the acquisition of Merrill by Bank of America. The complaint alleges that the joint proxy statement violated Section 14(a) of the Securities Exchange Act and Rule 14a-9 because it contained materially false and misleading statements.

Specifically, the complaint alleges that Bank of America represented in the proxy statement that Merrill had agreed not to pay year-end performance bonuses or other discretionary incentive compensation to its executives prior to the closing of the merger without Bank of America's consent. Bank of America, however, failed to disclose that it already had consented to Merrill's payment of up to $5.8 billion in discretionary year-end and other bonuses to Merrill executives for 2008. Bank of America's agreement to allow Merrill to pay these discretionary bonuses was set forth in a separate document that Bank of America omitted from the proxy statement. The substance of this separate agreement was never disclosed to shareholders prior to their vote on the merger. The complaint alleges Bank of America's omission of this information therefore rendered the proxy statement materially false and misleading.

At the time we filed our complaint, the Commission submitted a consent judgment for the court's consideration under which the case against Bank of America would be settled on terms that included the payment of a $33 million penalty by the company and the entry of a permanent injunction prohibiting it from further violations of the securities laws' proxy solicitation provisions. As you know, the Judge in the case declined to approve the consent judgment, and the litigation is thus ongoing.

The Judge's decision regarding the consent judgment does not affect the underlying case. We have continued to vigorously pursue the charges we filed against Bank of America, and have used the additional discovery available in the litigation to further pursue the facts and determine whether to seek additional charges. In determining how to proceed, we will, as always, be guided by what the facts warrant and the law permits. Trial of the case is scheduled to begin on March 1, 2010.

Because the enforcement action against Bank of America is ongoing, discussion of certain aspects of this litigation pose a risk of negatively affecting our case. Nevertheless, I am happy to discuss elements of the consent judgment or our publicly filed court papers that should not compromise our ability to bring this litigation to a successful conclusion.

With regard to the proposed settlement, we believe that it was reasonable, appropriate and in the public interest. The proposed settlement properly balanced all of the relevant factors that must be considered when assessing any settlement. Where a corporate issuer fails to meet its statutory obligations, the need for deterrence of similar misconduct is paramount. Among other things, the proposed $33 million penalty – which would have constituted the second largest penalty ever imposed in a proxy statement case – would have accomplished the following:

- The proposed penalty would have sent a clear message to corporations and those who advise them – and reinforced the previously articulated Commission pronouncement – that proxy statements must include the substance of a separate nonpublic document when the failure to do so results in a material misstatement or omission in the proxy statement. It also would have reiterated the principle that corporations are responsible for maintaining internal controls that prevent and detect misstatements contained in proxy statements. We believe that management at corporate issuers and their advisors would have received and understood this clear message.

- The proposed penalty also would have sent a strong message to shareholders that unlawful corporate conduct had occurred and that management failed to keep the company in compliance with the applicable laws. That message allows shareholders to better assess the quality and performance of management.

- The proposed settlement also would have undercut the position – now asserted by Bank of America – that there was no legal requirement to disclose such information.

Importantly, these objectives would have been achieved through a proper balance of imposing a significant monetary penalty that reflected the seriousness of the violations while not imposing undue financial burdens on shareholders. Although a $33 million penalty is a significant amount, it is unlikely to have a material adverse financial impact on individual innocent shareholders given the approximately 8 billion outstanding shares of Bank of America stock.

The actions in this proposed settlement do not reflect a change in the Commission's approach to pursuing charges against individuals that violate the federal securities laws. The Commission has been and will continue to be aggressive in bringing actions against individual wrongdoers that violate the securities laws. Moreover, the Commission will continue to vigorously pursue penalties from culpable individuals, including culpable corporate executives. Indeed, the Commission has a strong record of charging and seeking substantial penalties from individual executives in recent cases, and we will continue to do so in the future.[1]

Your letter of invitation also asked why our complaint charges only the corporation and not individual executives or lawyers for the companies. The SEC pursued all of the charges we believed were appropriate based on the investigative record and the applicable law. Section 14(a) of the Securities Exchange Act, which governs proxy statements, is directed to those who solicit proxies or in whose name proxies are solicited. In this case, it was the corporations – Bank of America and Merrill – that solicited the proxies and in whose name they were solicited. The corporation therefore had the legal obligation under Section 14(a), and we charged that the corporation failed to meet that obligation.

Conversely, in order to establish that individuals aided and abetted a Section 14(a) violation or committed fraud in violation of Section 10(b) of the Exchange Act, it would

---

[1] *See, e.g., SEC v. Brookstreet Securities Corp.*, No. SACV 09-01431 DOC (ANx) (C.D. Cal. 2009) Lit. Rel. No. 21328 (December 8, 2009) (charging company president/CEO for fraudulently selling risky, illiquid CMOs to retail customers); *SEC v. Morrice, et al.*, No. SACV09-01426 JVS (C.D. Cal. 2009) Lit. Rel. No. 21327 (December 7, 2009) (charging individuals for misleading investors about the company's subprime mortgage business); *SEC v. Greenberg, et al.*, No. 09-cv-6939, 2009 WL 2413951 (S.D.N.Y. Aug. 6, 2009) and *SEC v. American International Group, Inc.*, No. 06-cv-1000, 2006 WL 305791 (S.D.N.Y. Feb. 9, 2006) (corporate and individual charges for fraudulent accounting scheme); *SEC v. Mozilo, et al.*, No. 09-cv-03994, 2009 WL 2341660 (C.D. Cal. June 4, 2009) (charging individuals for knowingly misleading investors about company's condition); *SEC v. Strauss, et al.*, No. 09-cv-4150, 2009 WL 1138823 (S.D.N.Y. Apr. 28, 2009) (charging individuals for accounting fraud and for knowingly misleading investors about company's condition); *SEC v. Biovail Corp., et al.*, No. 08-cv-2979, 2008 WL 260474 (S.D.N.Y. Feb. 4, 2009) (same); *SEC v. Analog Devices, Inc. and Jerald Fishman*, Lit. Rel. No. 20604 (May 30, 2008) (charging corporation and CEO for stock options backdating); *Federal Home Loan Mortgage Corp., et al.*, Lit. Rel. No. 20304 (Sept. 27, 2007) (charging corporation and four executives with accounting fraud); *SEC v. Conagra Foods, Inc.*, Lit. Rel. No. 20206 (July 25, 2007) (charging corporation, subsidiary and eight individual executives with improper and fraudulent accounting practices).

have been necessary to prove individual scienter. To establish aiding and abetting, the statute requires that a person knowingly provide substantial assistance in support of a violation. The scienter element of a Section 10(b) violation similarly requires knowing or reckless misconduct. In contrast, scienter is not an element of a Section 14(a) violation. Based on the investigative record that existed at the time, we did not believe that we could fairly and properly assert scienter-based charges against individuals under the applicable legal standards. Of course, as I stated above, we have used the additional discovery available in the litigation to further pursue the facts and determine whether it is appropriate to seek additional charges in this case.

Another issue presented in the investigation was Bank of America's assertion of the attorney-client privilege during the investigation. As a matter of law, the Commission simply cannot compel parties to waive the attorney client privilege, a privilege that under the law serves important interests. Courts have held that parties' assertions of reliance on counsel made during the course of *an investigation* generally do not result in a waiver of the privilege. Court findings of privilege waivers generally have been limited to assertions of reliance on counsel made during the course of *judicial proceedings*. Commission staff therefore did not believe it had a sufficient legal basis to pierce the privilege. Once the case transitioned to contested litigation, we sought additional avenues for discovery that became potentially available. We ultimately reached agreement with Bank of America on the terms of a court order governing disclosure of information Bank of America previously had withheld on the basis of legal privileges. That order resulted in a broad waiver of the attorney-client privilege on matters relating to the Bank of America case.

Conclusion

In sum, we have vigorously pursued and will continue to vigorously pursue our charges against Bank of America and take all necessary steps in an effort to prove our case in court. Enforcement is one of our core responsibilities and a central part of our heritage as an agency. Now more than ever, it is critical that our Enforcement program help support investor confidence in the agency and in the marketplace.

Thank you for the opportunity to address these important issues. I look forward to answering your questions.

Chairman TOWNS. Thank you very much.

Again, we apologize for the break, but we have to vote around here.

Mr. Khuzami, I know you are currently preparing the case against Bank of America. I don't want to do anything or say anything that is going to jeopardize your case, but in general what is the SEC—what do they believe Bank of America did wrong? What do you think happened here that was wrong?

Mr. KHUZAMI. Mr. Chairman, in our complaint we allege that the proxy materials that were sent to shareholders, which was the basis upon which they would decide as to whether or not to vote to approve the merger, stated that Merrill Lynch could not pay discretionary bonuses without the consent of Bank of America.

In fact, what the proxy solicitation did not disclose, that there already had been an agreement that Bank of America would allow Merrill to pay up to $5.8 billion in exactly those kinds of bonuses. So the proxy was misleading because it suggested that no consent had been given and no such bonuses would be paid without such consent when in fact the consent had already been given.

Chairman TOWNS. I know you are a very serious prosecutor, and that is what we need in this day and age.

What can we expect from the SEC going forward in terms of aggressive enforcement against corporate wrongdoers? What can we expect from this point on? We are talking about a lot of money here.

Mr. KHUZAMI. I understand.

Look, first, I would point to the recent cases that we have brought against corporate executives. In the mortgage fraud area alone we have charged the CEOs, the CFOs, or other senior executives in New Century, Countrywide, American Home Mortgage, Brookstreet Securities. We charged Hank Greenberg and another official at AIG. Just in the recent past we have gone vigorously after those individuals who we believe were heading companies that engaged in one form or another of fraud or wrongdoing, particularly with respect to mortgage and mortgage-related products.

So I think past is prologue, and you will continue to see that kind of approach. Under Chairman Mary Shapiro, we are embarking on a number of internal efforts to streamline our processes and make ourselves more responsive, but we are reinvigorated and rededicated to that effort.

Chairman TOWNS. But you do feel that you have the tools to be able to do the job that needs to be done, that no legislation or anything is required in order to be able to move forward with this aggressive approach? The word around here now is robust approach.

Mr. KHUZAMI. Robust, yes. Yes. We have a number of legislative proposals that we have presented, particularly involving hedge fund registration; the creation of a central clearing party for derivative transactions; more and better information on exactly the kind of trading and activity that goes on in some of these over-the-counter and opaque markets.

In addition, we have sought legislation regarding nationwide service of process and some other things to help make our job easier.

And last, of course, funding is a significant issue. We have—I think the last statistics I saw—over 35,000 regulated entities that the SEC is responsible for between issuers, broker-dealers, investment advisors, transfer agents, credit rating agencies; and that is before we get to hedge fund registration.

Despite those numbers, the enforcement staff is 1,100, total. I think that additional funding would also go a long way toward helping us complete our mission.

Chairman TOWNS. Thank you very much. Thank you for your testimony.

I now yield to the gentleman from California, the ranking member, Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman.

Mr. Khuzami, I know you were not on board on December 18th of last year, but are you familiar with the document dated December 10th, which was delivered to the Fed on that date, which is called the "fourth quarter 2008 walk-down," the so-called "walk-down document?"

Mr. KHUZAMI. I do not believe that I have seen that, Congressman.

Mr. ISSA. Mr. Chairman, I ask unanimous consent this be placed in the record at this time.

Chairman TOWNS. Without objection.

Mr. ISSA. It is already in our information, but I want to make sure it is in the record at this point.

Chairman TOWNS. Without objection, so ordered.

[The information referred to follows:]

Merrill Lynch & Co.
ML&CO Daily Pacing (Internal Basis)
As of close of business December 10th, 2008

	Oct'08	Nov'08			Dec'08F			4Q'08F		
	Actual	Est a/o 12/5	Actual	Delta	Est a/o 12/5	Current	Delta	Est a/o 12/5	Current	Delta
Revenue ex Marks ex One-Time	1,130	1,494	1,388	(106)	1,456	(449)	(1,905)	4,080	2,069	(2,011)
Marks	(2,719)	(2,989)	(3,789)	(800)	(1,000)	(1,100)	(100)	(6,709)	(7,609)	(900)
Significant Items (Non-Marks)	(2,619)	(1,481)	(1,661)	(180)	-	(1,200)	(1,200)	(4,100)	(5,480)	(1,380)
FVAs	(1,078)	260	260	0	-	(194)	(194)	(818)	(1,012)	(194)
Total Marks/Significant Items	(6,417)	(4,210)	[redacted]	(980)	(1,000)	[redacted]	(1,494)	(11,627)	[redacted]	(2,474)
Total ML&CO Revenue	(5,287)	(2,716)	(3,802)	(1,086)	456	(2,943)	(3,399)	(7,547)	(12,032)	(4,485)
Comp	1,051	883	781	102	888	941	(53)	2,822	2,773	49
Non-Comp	612	655	668	(13)	944	782	163	2,211	2,062	150
VICP	495	550	553	(3)	252	97	156	1,297	1,145	153
Total Expenses ex One-Time	2,158	2,089	2,002	87	2,084	1,819	265	6,331	5,979	352
FF/ARS	92	-		-	-	-	-	92	92	-
Restructuring	(1)	-	4	(4)	-	-	-	(1)	3	(4)
Temasek	-	-		-	-	-	-	-	-	-
PTE	(7,536)	(4,804)	(5,807)	(1,003)	(1,628)	(4,762)	(3,134)	(13,969)	(18,105)	(4,137)
ATE	(4,536)	(3,075)	(4,756)	(1,681)	(1,328)	(3,200)	(1,872)	(8,939)	(12,493)	(3,554)
Tax Rate	39.8%	36.0%	18.1%	17.9 pts	18.4%	32.8%	(14.4) pts	36.0%	31.0%	5.0 pts

Note 1: During November close, decision was made to use 31% tax rate for 4Q08F. The delta between 36% prior rate and 31% is a true-up in November.
Note 2: Forecast does not include write-off of goodwill in the banks which is currently under evaluation.

Mr. ISSA. I apologize; December 17th I believe it was delivered. It probably would not surprise you to know that it actually—on page 6 it lays out those bonuses. Mr. Bernanke, Mr. Paulson had that on those days in December.

Had you been in the room when this was delivered—in other words you, the SEC—would you have then been aware of the failure of the proxy in time to at least begin action at that point in December?

Mr. KHUZAMI. Well, I guess you would have to know exactly what was said in the proxy and compare that to the information that was then available.

Mr. ISSA. But you knew that. You have compliance people. You were hand-in-hand, and you get paid to make sure that the public is protected throughout the process of a merger.

So let me ask you the real question. We are the Government Oversight Committee, and it is a double entendre because we oversee the government.

We are also the government entity that oversees a number of things that are outside the government; but in this case, the Federal Reserve, the Treasury, and the SEC—as I understand it through testimony again and again, the SEC was locked out of this process during that time and did not get into the process until January.

Isn't that correct? Your agency was not informed of what the Fed was doing or the Treasury was doing, and you were not at these meetings? You were conspicuous in your absence, right?

Mr. KHUZAMI. I understand that is correct, yes.

Mr. ISSA. So from a standpoint of the Securities and Exchange Commission, the respect the Treasury and the Fed should show in the future, shouldn't you be at the table if tens of billions of dollars of taxpayers' money are being thrown in to complete a merger; and at the moment that an executive, a party says, I'm looking at the MAC clause, I'm looking at breaking up this because things have changed, or things were not disclosed, or we have learned something, wouldn't that, in your opinion, be an absolute mandate for the Securities and Exchange Commission to be in the room from that time forward?

Mr. KHUZAMI. Congressman, I think if it was a matter that impacted on the SEC's jurisdiction or responsibilities with respect to shareholder disclosure, regulation of the securities markets, the answer would be "yes."

Mr. ISSA. Now I'm going to ask you a hypothetical, but it is not much of a hypothetical. If you'd been in the room on September 17th, 18th, 19th, if you'd been in the room when they said, this is not going to go forward because there have been material adverse effects, and on top of that, you were aware of misstatements in the proxy, would you have interjected at least your oversight, your opinion, and your demand that compliance to law be adhered to, which it wasn't?

Mr. KHUZAMI. Well, I'm not sure that I would have commented on whether or not a MAC clause was properly invoked or not.

Mr. ISSA. But we have already had testimony that if they invoked the MAC, they have to go back to the stockholders.

Mr. KHUZAMI. Correct.

Mr. ISSA. The Federal Government came in with $20 billion—and there's some debate about whether it was forced on B of A or B of A demanded it. Regardless of which one that is, at that point when there's new money, a MAC clause, or money in lieu of you, and on top of that, material misinformation in the proxy, shouldn't you be in the room; and more importantly, if you are in the room, wouldn't you have acted to at least advise—and let's assume you're willing to take on the Fed chairman and the Secretary of the Treasury—that, in fact, they're crossing lines at that point that should not be crossed, they are failing to disclose to the very stockholders, the public that you protect?

Mr. KHUZAMI. If those events triggered disclosure obligations, we would certainly communicate that.

Mr. ISSA. For Christ's sake, we have had five, six hearings. Mr. Kucinich has dedicated probably a whole wall of his library to this very question. And you're saying "if."

Let's go back again. They failed to disclose these bonuses. The Fed and the Treasury became aware of that. They also became aware that these losses were mounting, and through a negotiation behind closed doors in which you were locked out, they negotiated additional money, now repaid, but additional money to make BofA go through with this deal or to encourage or, in fact on their demand, to have them go through.

So all of that occurred with your agency locked out of the room. Are you going to tell me today—if there was something to be reported, are you going to say, like Sheila Bair that was here earlier, Yes, I would like to have been in the room, and if I had been in the room, or when I was in the room, I wish I had said or done more.

Which is it? Are you going to say the SEC should darn well be in the room and be protecting stockholders, or are you going to say "if," "if," "if" today? Which one is it?

Mr. KHUZAMI. Perhaps I didn't make myself clear.

Mr. ISSA. I think I did.

Mr. KHUZAMI. Yes, you did. Very clear.

My only point was that we would certainly like to be in the room any time there are discussions that go on that affect shareholders and the entities and individuals that we regulate and protect. My only point was a more modest one—whether or not discussions about invoking a MAC clause necessarily triggered disclosure obligations under the Federal securities laws.

Mr. ISSA. Thank you.

Thank you, Mr. Chairman, for your indulgence. I think we made the point that Mr. Kucinich and I have both been wanting to make, and I look forward to continuing to followup on it.

I yield back.

Chairman TOWNS. Right. At this time I would yield to the Chair of the Domestic Policy Subcommittee, the gentleman from Ohio, Mr. Kucinich.

Mr. KUCINICH. Mr. Chairman, I just want to say at the outset to my friend from California that there's a distinction between what you're discussing and what our subcommittee has been doing; and that is that you're talking about disclosure events that occurred after the shareholder vote. Our focus in this subcommittee has been about disclosure events before the shareholder vote.

Now, Mr. Khuzami, my subcommittee investigation has found that Bank of America relied on the November 12th forecast for fourth quarter 2008, created by Merrill Lynch, that omitted any forecast of how collateralized debt obligations, subprime mortgage-backed securities, credit default swaps, would perform in the quarter.

The former Merrill CFO admitted to staff that the November 12th forecast was not in fact a valid forecast. Bank of America knew at the time that the November 12th forecast was of questionable validity; it's in quotes. However, Bank of America did not do any actual financial analysis to make up for the Merrill omissions. Instead, Bank of America merely pulled out of thin air a number on November 13th, which was recorded on the forecast document as the "gut" feeling of Neil Cotty, Bank of America's chief accounting officer.

The attorneys at Bank of America and at Wachtell Lipton did not question; in spite of the omission and the explicit reference to a "gut" feeling, they advised Bank of America not to make further disclosures to its shareholders in advance of the merger vote based on the information in the deficient forecast and a "gut" feeling.

The November 12th forecast omission of any projection for losses and the CDOs and other liquid investments and the implication that Merrill Lynch would break even in those investments for the remainder of the quarter was material to the advice attorneys gave Bank of America.

Now when I asked Ken Lewis about this at our first hearing, he told us he relied on advice of counsel. Protecting shareholders is often, in the final instance, the responsibility of corporate general counsels and/or outside counsel. This subcommittee's investigative findings demand the question: Where were the lawyers, the glaring omissions, inaccurate financial data, and the critical November 12th forecast so obvious that they should have alerted the attorneys to a necessity of a reasonable investigation before making a decision on Bank of America's legal duties to disclose. The apparent fact they did not mount such an investigation makes the decision not to disclose Merrill's loss to the shareholders an egregious violation of security laws.

Mr. Khuzami, in March, GAO issued a scathing report on the effect of Christopher Cox's leadership of the SEC in reducing corporate penalties and formal investigations at exactly the time that the CDOs and CDSs were proliferating. To Chairman Shapiro's credit, she rescinded the Cox policy and appointed you to reinvigorate the Enforcement Division.

Now I am concerned that one pernicious aspect of the Cox legacy may have survived: the unwillingness to pursue, as GAO wrote, "more complicated cases, those with industrywide implications, in favor of those seen as more routine."

Mr. Khuzami, this is the test case. This is the case with industrywide implications, where what is at issue is the performance of the attorneys in interpreting the Nation's security laws strictly or permissively. Here's the case where the SEC's Shapiro breaks with the SEC's Christopher Cox.

Mr. Khuzami, is the SEC widening its investigation to include the issue of Bank of America's failure to disclose to its shareholders the mounting losses at Merrill Lynch, known or knowable by mid-November 2008, weeks before—weeks before the shareholder vote on the merger?

Mr. KHUZAMI. Congressman, we have been and are looking at all aspects of the activity with respect to the proxy statements, including the fourth quarter losses at Merrill Lynch.

Mr. KUCINICH. Is that a "yes" or a "no?"

Mr. KHUZAMI. That's a yes.

Mr. KUCINICH. If it's a "yes," then the work of this committee has been worthwhile, because you now have a chance to do your job. Because we have done ours, and the information that we have uncovered should facilitate your investigation.

I thank the gentleman.

I thank the Chair. I yield back.

Chairman TOWNS. Thank you very much.

I now yield to the gentleman from Missouri, Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Mr. Khuzami, Messrs. Bernanke and Paulson were negotiating with Merrill Lynch and Bank of America and sort of came to an agreement, yet they didn't disclose this. They didn't want to put in writing the transaction that they were about to embark on here and about to approve and had been working with. My understanding is that once they did that, that would have been a disclosable event that the SEC would have been able to come into and be a part of and have some oversight over.

What is your opinion of this transaction and how it all happened, and this unwillingness to put this in writing?

Mr. KHUZAMI. Congressman, what the securities laws require is that if that understanding had solidified to a material contract, then it would have been required to have been disclosed under what is known as Form 8-K. So Bank of America would have had to make a disclosure if it rose to the level of an enforceable contract.

Mr. LUETKEMEYER. But isn't this skirting the law by them saying, We are going to have a little wink-and-nod agreement here and let's just have a gentleman's handshake on it? I mean, aren't they trying to subvert what really is a necessary part of a transaction, the disclosure to all parties involved?

Mr. KHUZAMI. Congressman, it wouldn't be appropriate to comment on my views of that in light of the ongoing nature of the investigation, but certainly there can be circumstances where there's an enforceable contract, even though it's not formally written down, in which case it may trigger the disclosure obligations.

Mr. LUETKEMEYER. Following along that process, do you see something that's happened here that you think needs to be changed in existing law? Do we need to have something more clarified by the way we have these transactions take place, so that there's more disclosure?

Mr. KHUZAMI. Congressman, we sort of constantly review our disclosure rules and regulations to determine whether or not more disclosure or different disclosure is appropriate. That process is ongoing now. The Sarbanes-Oxley Act required us to consider more real-time or robust disclosure, and that is a process that continues. We would certainly take the experience here and determine whether or not we should change our rules and regulations appropriately.

Mr. LUETKEMEYER. You still haven't said, yes, there are some things we need to do, and they are—can you fill in the blank?

Mr. KHUZAMI. The question whether or not events such as these should require more affirmative disclosure obligation is something that we are considering. So, for example, contracts or discussions short of a formal, legally enforceable obligation, should that be disclosed even though all the terms are unfinalized or interim results that may not rise to the level of a material impairment of an asset, which is the current standard, whether or not that should be disclosed.

Mr. LUETKEMEYER. Are you currently looking at that with your rules and regulations, or do we need to have some congressional action? What do you think we need to do?

Mr. KHUZAMI. Congressman, that is something that we look at on a regular basis and we are looking at now.

Mr. LUETKEMEYER. As someone who has gone through this and been in the middle of it—and we are in the process now congressionally to try and do something with this too-big-to-fail situation—what do you see that we are not doing with the legislation that's proposed that you think would be advantageous or a big aid to you, or would be something that we could do in the future to mitigate or minimize some of the things that have gone on?

Mr. KHUZAMI. Congressman, from an enforcement perspective, which is my perspective, transparency and information are critical. We cannot determine if misconduct is going on in markets if we don't have complete and accurate and standardized information about what is going on. So, for example, registration of hedge funds, which would require better reporting and stronger client and inspection authority, would be highly beneficial.

Mr. LUETKEMEYER. Transparency and registration is in the bill right now. Does it go far enough? Does it go too far? What is your opinion?

Mr. KHUZAMI. I'm not sure I understand the full and complete details of what is in the current version of the bill, so if I could have an opportunity to respond to you, I would appreciate that.

But the same is true in the derivatives markets. We would like that kind of information.

One case we brought, for example, recently, involved insider trader, which typically takes place in the equity world, in stocks, was actually going on in the credit default swap market. Yet we don't have nearly the same kind of information in that market as we do in the equities.

Mr. LUETKEMEYER. Interesting. Thank you, Mr. Khuzami.

Thank you, Mr. Chairman.

Chairman TOWNS. The gentleman's time has expired.

I now call on the gentleman from Baltimore, Mr. Cummings, who is a very active member of this committee.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Mr. Khuzami, I've got to tell you, as I listened to my good friend and colleague, Congressman Kucinich, he said, "Our work is done." And I don't think our work is done. Let me tell you why.

As you know, the SEC, in the case of the *SEC* v. *Bank of America,* there was a settlement that was submitted to the Federal court in New York on August 3, 2009. The settlement agreement provided for the Bank of America to pay $33 million in fines for making false and misleading statements in proxy statements to shareholders. Bank of America, of course, told shareholders that no year-end bonuses would be paid to Merrill Lynch executives, when in fact it had been agreed that Bank of America would pay up to $5.8 billion in bonuses to Merrill executives.

Putting aside the fact that $5.8 billion was to be paid to the executives of a company that was hemorrhaging money at the time, the decision to settle the matter for $33 million struck many of us as being a perverse outcome. Here was a company with $45 billion in government assistance, $20 billion of which was from this exact deal; and the Securities and Exchange Commission let them pay a fine. And this is the piece that got me: Pay a fine with our money, with taxpayers' dollars.

Does this strike you as fair to the taxpayer shareholders? Does it fit your mission of protecting American investors?

To me, it's like you fine somebody and then take somebody else's money to pay the fine. And I'm trying to figure out, where is the punishment in that, where is the enforcement in that? If I'm sitting back, I say, "Oh, boy, a great day here; got the public's money to pay the fine. Everything is fine. I don't have to pay a dime."

And then one of the things that I read about the settlement—once I read about it, I fired off a letter to your inspector general, David Coates, asking him to look into the settlement. I just read in Mr. Coates' recent semiannual report to Congress that he is in the midst of this investigation, and I look forward to his conclusions.

One of the main reasons I requested the investigation was because I would not be the least bit surprised that in the aftermath of this crisis that further securities laws violations are uncovered and the violations may have occurred at a firm that has received government assistance.

In that case, what is the calculus that is used to determine how to punish a company without penalizing the involuntary investors in the firm, the taxpayers? I want you to understand I'm concerned about, when we catch folks, what is the thinking that goes into the process of how to punish them? Because, to me, this was not punishment, and I'm glad the judge did reject it.

I know you may not be able to talk about the case, but I assume you can talk about what goes into your thinking as the No. 1 guy who addresses these issues.

And the only person that you answer to is Ms. Shapiro, Mary Shapiro; is that right? It's you and straight up to her; is that right?

Mr. KHUZAMI. That's correct.

Mr. CUMMINGS. So help me with this. As a lawyer, when I read this, I got so upset because, I said, it makes absolutely no sense. And I know you've got a great answer for me, and I'm waiting to hear it.

Mr. KHUZAMI. Congressman, let me take each of those.

First, with respect to the amount of the fine. The penalties that we assess have to be proportionate to the actual wrongdoing that occurred. And here the wrongdoing was not the payment of the bonuses. That may be excessive and wrong as a policy matter, as a corporate governance matter, as a number of other matters; but from a pure enforcement point of view, the wrong was to fail to disclose to shareholders that they said that they would not pay bonuses without Bank of America's approval when they had already agreed to pay the money.

And so the wrong was the depravation of information to the shareholders in deciding how to vote, not the fact that the amount of money that was paid was illegal or improper in and of itself. So we look at the wrongdoing.

Mr. CUMMINGS. They had a duty to disclose; is that right?

Mr. KHUZAMI. Yes, they have a duty to make sure the statements in the proxy are not misleading. So the number of $5.8 billion, although it was $3.6 billion that was ultimately paid, is not, I don't think, the measure of the wrong. The wrong was that they did not tell shareholders who needed all the information they could to decide whether or not to vote. So that was the starting point.

Then we look at the amount. We looked at our precedent. In the proxy violation area, the largest fine that we had imposed was $38 million, give or take or so, in a case involving, frankly, more egregious conduct than this because it involved manipulation of their stock and obstruction and other things, in addition to the proxy violation.

Next, we try and balance the benefit of the penalty versus the burden on the shareholders. So we recognize the penalties that we assess may come out of the pockets of shareholders who may themselves have been wronged by the conduct. So we try and balance. But we have to still impose the penalties because it sends a strong deterrent message to other corporations and other issuers that this kind of conduct will not be tolerated.

The deterrence message is critical. It tells others they shouldn't do it. It says that if you do it, you're going to pay a cost. It incentivizes them to fix their own problems before we come knocking. It allows us to leverage our limited resources so that companies voluntarily engage in corrective measures rather than us having to go to each one of them. The lawyers read these things, the corporate executives read these decisions; they implement changes.

So there's many good reasons to have the penalty, but we don't want to burden the shareholders more than necessary. That's a balancing that we look at under our penalty guidelines, and we come to the best determination that we can.

Mr. CUMMINGS. I see my time is up. Thank you, Mr. Chairman.

Chairman TOWNS. The gentleman's time has expired. The gentlewoman from California, Ms. Speier.

Ms. SPEIER. Thank you, Mr. Chairman.

Mr. Khuzami, I am deeply troubled by your description of what took place. You said that the bank misled the shareholders. The bank didn't mislead the shareholders. It lied to the shareholders. It was a bald-faced lie.

Now, on a proxy statement, if you make a bald-faced lie, I think that you should have a penalty that is so strong that you won't ever do it again.

Now the courts seem to believe that $33 million was insufficient. Who initiated the settlement?

Mr. KHUZAMI. Congresswoman, this was a settlement that was——

Ms. SPEIER. Who initiated it? Did SEC go to the Bank of America and say, let's settle this; or did the Bank of America come to the SEC and say, let's settle this?

Mr. KHUZAMI. I don't know the answer to that, Congresswoman. Typically, settlements result from both parties coming together and discussing the possibility of settlement.

Ms. SPEIER. Someone initiates it. If you don't have the answer today, I'd appreciate it if you would make that available to the committee.

Mr. KHUZAMI. Certainly.

Ms. SPEIER. You based your decision on the fact that there was a precedent where $38 million was fined in another setting.

Now, you know that the SEC, historically, when you were not a member of the staff, was reducing its enforcement actions dramatically. In fact, the recent GAO study indicated that the enforcement actions had been reduced by some 80 percent and the disgorgement actions I believe by some 60 percent. Presuming those figures are indeed accurate—I may be off a little bit—you're basing a decision on whether or not to impose a fine on a very anemic SEC that was not doing a good job of enforcing the law.

So I guess my real question to you is, if something is substantive, if something is significant, if it is a lie, shouldn't the penalty reflect that? I'm not accepting the fact that somehow, because there was another fine issued before, that somehow should be a measurement, when we know that the SEC wasn't doing its job.

Finally, your argument that somehow you've got to balance what happens to the shareholders, if that's the deliberative process you're going to use, then the appropriate fine is never going to be imposed on companies that do, in fact, lie.

Mr. KHUZAMI. As to your latter point, the harm to shareholders who may have been victimized by the wrongful conduct is only one factor amongst eight or nine that we take into account, one of which is the importance of the deterrence impact of the penalty. So I don't want to mislead you to suggest that we only look at whether or not there's harm to shareholders. We look at a variety of factors, including, most importantly, the deterrent effect of the fine.

Ms. SPEIER. Let me ask you this. Based on what the judge has said in this case, if you were to start over again, what would be the fine that you believe would be appropriate for a proxy statement that had a bald-faced lie in it, that shareholders relied on—or prospective shareholders relied on in terms of purchasing the stock?

Mr. KHUZAMI. Congressman, I think the judge's concern in his opinion had to do more with whether or not the fine was too high, because he felt that it was falling—the burden was falling on shareholders who had been victimized by the wrongful conduct, not that it was too low.

But reasonable minds can have different opinions on that issue. My belief is the settlement that we struck was fair and appropriate.

Ms. SPEIER. So in terms of further negotiations, will there be another settlement offered up to the judge, or will this go to trial?

Mr. KHUZAMI. The matter is scheduled for trial in early March and the case is proceeding.

Ms. SPEIER. So there will not be any further settlement on this case?

Mr. KHUZAMI. I couldn't predict the future as to whether or not the case will settle or not. As of now, the case is proceeding in the discovery phase and it's scheduled for a March trial.

Ms. SPEIER. I just want to understand. Could you then go back and negotiate a smaller—is what you're saying, that the judge wants a smaller fine imposed? I find that absolutely unbelievable.

Mr. KHUZAMI. No. My only point was that, in the judge's opinion, he indicated that he was concerned about the penalty because he thought that it was being imposed on shareholders who were victimized by the wrongful conduct.

Ms. SPEIER. His opinion was not based on the fact that the fine was too low?

Mr. KHUZAMI. I don't remember whether or not he used exactly those terms, but his point was more that the fine was—sorry to repeat myself—but the fine was falling on the shareholders victimized by the wrongful conduct.

Ms. SPEIER. Or maybe his focus was that the fine should be imposed on the executives who misled the shareholders and maybe have it taken out of their salaries.

Mr. KHUZAMI. He did question why no individuals were charged, you're absolutely right; but he didn't suggest that the fine should be paid out of the pockets of individuals or particular corporate executives.

Chairman TOWNS. The gentlewoman's time has expired.

I now yield 5 minutes to the gentleman from Ohio, the ranking member on the subcommittee.

Mr. JORDAN. Thank you.

Mr. Khuzami, were you here for Ms. Bair's testimony and questioning earlier this morning?

Mr. KHUZAMI. Yes, I was.

Mr. JORDAN. So you're aware of what she said in confirming what Mr. Lewis had told this committee about the meeting that took place in October, 10 days after TARP had passed, where the nine biggest financial institutions were brought to this town, including Bank of America, and told they were going to have their bank partially nationalized, they were going to have to accept TARP money, they had to sign a form. You heard all that testimony that she gave?

Mr. KHUZAMI. Yes.

Mr. JORDAN. I guess my point is or my question is—well, let me go back to this.

Her testimony to this committee a few hours ago was that action by the Fed, by Mr. Paulson—Treasury Secretary Paulson and Federal Reserve Chairman Bernanke took her breath away when she saw what took place at that meeting.

So now, as we move forward, it seems to me that—I guess your testimony—and I apologize for not being here, I was at another commitment. You talked about shareholders being misled. But it seems to me that this unbelievable involvement by the government, the e-mail we have that's been part of the record in earlier hearings from Mr. Lacker, Federal Reserve Bank of Richmond, where he talked about the fact they didn't want a disclosable event so Mr. Paulson, Mr. Bernanke were not willing to put anything in writing about the willingness to help Bank of America with additional TARP dollars.

I mean, it seems to me that someone looking at this can say, you know, Bank of America—what was the government's culpability here in running the show and pushing for this deal, particularly Mr. Paulson and Mr. Bernanke?

I assume you at the SEC are looking at—I mean, that has to, in my mind, factor into this whole picture, this whole scenario that we have been looking at now for several months. Any response you would have to all that?

Mr. KHUZAMI. Congressman, as we look at these events, we look at the roles of all the participants that are relevant and all of the facts. I guess that would be my response.

Mr. JORDAN. Yes or no, would potential arguments by Bank of America that the bank and its management were not necessarily completely liable because they were acting at the government's directions?

Mr. KHUZAMI. Well, events that you're talking about I believe occurred after the proxy, and so after the merger had been approved. And so the question is whether or not—with respect to the TARP money, whether or not that understanding had become a material contract that had to be disclosed under the 8-K rules and regulations. So that is certainly an issue.

Mr. JORDAN. When did you guys first become aware of what was taking place or the mounting losses at Merrill Lynch? When did you first become aware of that?

Mr. KHUZAMI. Unfortunately, I wasn't there until March, so I can't—I don't know the answer to that question.

Mr. JORDAN. Why do you think—when we have the e-mail saying we don't want disclosable, why do you think there was a reluctance by the Federal Reserve not to have information be made known to the SEC?

Mr. KHUZAMI. It probably wouldn't be appropriate for me to speculate about that.

Mr. JORDAN. Mr. Chairman, I yield back.

Chairman TOWNS. Thank you very much.

I now yield to the gentlewoman from California, Congresswoman Watson.

Ms. WATSON. Thank you, Mr. Chairman, and thank you for this followup hearing. We have had several in the past, and after listening to the testimony from the Bank of America CEO Kenneth Lewis; the Federal Reserve chairman, Ben Bernanke; former Treasury Secretary Hank Paulson; and officials at the Bank of America, there's still strong questions. And I know the intent of this committee, through its Chair, is to get some of these questions answered so we will know really what took place.

We want to hear from you the role of the government and what was played in the negotiations; the quality of the Bank of America's due diligence process; and the motivation behind BofA's attempt to claim a material adverse change [MAC], and the adequacy of their disclosure to shareholders.

Can you package all that and clarify it for us? I think this is what, the third or the fourth hearing, Mr. Chairman?

Chairman TOWNS. Fifth.

Ms. WATSON. Fifth.

Let us hear how you would describe the roles that each one of these sectors played.

Mr. KHUZAMI. Well, Congresswoman, involving some or all of the matters that are currently under investigation, I have to be careful about my comments.

With respect to the proxy that was sent out in connection with the merger, as we have charged in our complaints, we believe that the disclosure was misleading because Bank of American did not disclose that they already had an agreement to pay bonuses, when they told shareholders that Merrill Lynch would not be paying such bonuses without their consent; but, in fact, consent had already been given. That is the case we charged and that is the case that is proceeding.

Ms. WATSON. Let me stop you and I want to query these bonuses.

Ethically, I don't see how the bonuses could even be in contention when we are bailing out too-big-to-fail institutions with taxpayers' moneys to try to capitalize these big institutions so they can save people's homes, etc.

Is a bonus appropriate under the crisis conditions that exist? I just want you to talk about bonuses, and then continue.

Mr. KHUZAMI. Well, Congresswoman, again, from an enforcement perspective, my focus is on what the law requires and whether or not the law has been violated.

Ms. WATSON. Do bonuses fall under that provision in the law?

Mr. KHUZAMI. Generally not, except in this situation, where they made a representation about what they were going to do about bonuses, and that representation, in our view, was false.

Ms. WATSON. But that was prior to the collapse, wasn't it? When people signed their contracts, as I understand, they had bonuses attached in there. But the whole condition has changed now, where they have to comply with the provisions that were in the original agreement.

Mr. KHUZAMI. Well, that is correct. The bonuses that were paid in this case were paid, frankly, shortly after the merger was approved. That's correct.

Ms. WATSON. Would you continue on, please.

Mr. KHUZAMI. There's probably not much more. I don't mean to disappoint you, but probably not much more I would say on that topic. Whether or not bonuses are appropriate and the appropriate level, and the balance between incentivizing talent and retaining talent versus what is an appropriate compensation is probably something that is above my pay grade.

Ms. WATSON. I've heard that said, to retain talent. That really goes beyond—I feel it's so absurd. I don't think at this point that you couldn't find 1,000—or you could find 1,000 people out there with tremendous talent. If that talent goes, there are people lined up.

I mean, we are really being hit hard, and I'm talking about my district now, which is Los Angeles, Culver City, Hollywood. And people have lost their jobs in droves, lost their investments.

Talent is available, believe me. And so it's a phony, phony excuse. But in putting this all together, I feel there were tremendous failures on all sides. Would you agree to that?

Mr. KHUZAMI. I think there's a lot of blame to go around.

Ms. WATSON. Yes.

My colleague, Ms. Speier, said it was just downright lies that were given and possibly it was done so that government could support BofA and give them more support in the merger. So I'm just really thoroughly, thoroughly disappointed that the people that were in place, particularly at the SEC, looked the other way.

Thank you. I yield back.

Chairman TOWNS. The gentlewoman's time has expired.

I now yield 5 minutes to the gentleman from Missouri, Congressman Clay.

Mr. CLAY. Thank you very much, Mr. Chairman.

Thank you, Mr. Khuzami, for being here. Just a couple of questions. At what point should action have been taken to curb some of the activities of the big banks' involvement in the security market? There had to be some indication to the SEC that some investment houses were stretched too thin without the proper reserves to cover their risk in this market.

Did red flags or alarms ever go off? What did you know and when did you know it?

Mr. KHUZAMI. Congressman, I didn't arrive at the SEC until March of this year, so I'm probably not the right person to ask that question of.

Mr. CLAY. How about the people that you work with now that have been there for years? Did red flags go off for them?

Mr. KHUZAMI. Well, there were certainly systemic risks and a bubble that had occurred in the housing market and elsewhere that resulted in the collapse and the excessive leverage and risk-taking that we saw.

What the Commission saw at various points along the way, it's difficult for me to answer that question. We didn't have regulatory authority over certain areas. It might be better if I have an opportunity to respond to you after today's hearing, so I can give you a more fulsome answer.

Mr. CLAY. I'd love to hear from your colleagues in writing just what alarms went off or whether the relationship was too cozy with the big banks, that they never wanted to cite them for risky practices.

Let me ask you in particular, why did Bank of America get only a slap on the hand when it was cited in 2006 for improperly marketing auction rate securities? Why were they allowed to continue these practices of using false and misleading information in selling these instruments, in hindsight? Do you think the BofA was given too much leeway?

Mr. KHUZAMI. Congressman, I would have to familiarize myself with that case. I'm aware generally of the auction rate securities matter, but as I sit here, not with the particulars of whatever action may have been brought in 2006.

I'd be happy to respond.

Mr. CLAY. Would you respond to us and to the committee in writing on that issue also?

Mr. KHUZAMI. Certainly.

Mr. CLAY. Mr. Chairman, I have no further questions. I yield back.

Chairman TOWNS. Thank you very much.

Before we close out, let me just say, Mr. Khuzami, I'm troubled by the question the gentleman from Maryland raised, Mr. Cummings. It seems to me that individual executives, the ones who sign off on the proxy filings, should be the ones that are responsible. So, therefore, why wouldn't they be the ones that you go after, you know, fine them from the personal standpoint? Like he said, taking our money and then paying the fine. I'm not sure we get to where we need to go with that.

The other thing, the general feeling, in terms of the community at large, they feel that the reason the judge sent it back to you is that you were not aggressive enough, that you did not pursue it in the fashion that he felt it should have been. And, of course, that's the general feeling among people, as they say, "in the street," as to what's going on.

I don't know whether that's the case or not, but I do believe that you really need to look at that because when I listen to the fact that they are paying with our money, that doesn't encourage people to do what's right.

Mr. KHUZAMI. A couple of responses: First, with respect to the payment of the fine, obviously, any entity that receives TARP funding or other money still has to pay that full amount back, with interest. So whether or not a fine was paid with government money, which can tend to be fungible in an institution, but ultimately they had pay back all the money they got from the government with interest. I would just make that point.

Second of all, you're right, the judge expressed concern about not charging individuals. We have shown a very aggressive posture of charging individuals. If you look historically at our cases, the overwhelming number of cases result in charges against individuals and not corporations alone. I just mentioned some earlier today.

But the particular issue in the proxy area is that the proxy laws impose the obligation on the entity whose proxy is being solicited or on whose behalf it's being solicited, and those are the corporations.

To charge individuals, you need a higher level of proof. You need to show what is called scienter, or either knowledge or reckless conduct, meaning a significant and substantial deviation from normal standards of care. It is that difference in the legal standard that makes a difference in how we can proceed. There's a higher burden of proof with respect to the individuals; and our determination, based on the record we had, is that we did not have the basis to charge them as individuals.

Now as we get into the discovery process, we may get additional information, and we will take that into account. But I don't want to leave the impression that we do not aggressively pursue individuals. We recognize the deterrent impacts of charging individuals as much as corporate penalties deter people. Nothing substitutes for charging individuals. And we do that across the board in many, many, many of our cases.

Chairman TOWNS. Because the shareholders are really the ones who suffer in a case like this.

Let me thank you very, very much for your testimony. Of course, we really appreciate the fact that you're here and that you shared with us.

This is the end of many, many hearings that we have had on this. And of course we hope that we will now be able to move and to give the kind of confidence that people really need in order to turn the situation we now find ourselves in around. So I want to thank you again.

This hearing is now adjourned.

[The information referred to follows:]

ONE HUNDRED ELEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

2157 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6143

MAJORITY (202) 225–5051
FACSIMILE (202) 225–4784
MINORITY (202) 225–5074

www.oversight.house.gov

December 10, 2009

SUPPLEMENTAL MEMORANDUM

TO:	Democratic Members of the Oversight and Government Reform Committee
FROM:	Majority Staff, Domestic Policy Subcommittee
RE:	Findings of Possible Securities Law Violations in the Bank of America-Merrill Lynch investigation

Over the past nine months, the Domestic Policy Subcommittee, in conjunction with the Full Committee, has investigated possible securities laws violations in the Bank of America-Merrill Lynch merger. We have found evidence of possible violations in relation to Bank of America's failure to disclose mounting losses at Merrill Lynch, known or knowable in mid-November 2008, weeks before the shareholder vote to ratify the merger which occurred on December 5, 2008. This memorandum is intended to inform Members and staff about the nature and evidence of those potential violations.

Chronology

September 15, 2008 -- Bank of America and Merrill Lynch announced their merger.
November 3, 2008 -- Bank of America issued its proxy solicitation to shareholders.
November 12, 2008 -- Merrill Lynch produced an internal forecast of Fourth Quarter '08 results that projected a quarterly pre-tax loss of $8.9 billion. Bank of America was given a copy of this forecast document.
November 13, 2008 --Bank of America made a slight revision to the Merrill forecast, raising projected losses to $10.9 billion. Joe Price, Bank of America's CFO, met with the Timothy Mayopoulos, the company's General Counsel, to discuss shareholder disclosure obligations in light of the November 12 forecast.
November 13, 2008 -- Mayopoulos contacted Nicholas Demmo and Ed Herlihy, partners at Wachtell, Lipton, Rosen & Katz, a law firm working for Bank of America on shareholder disclosure and SEC filing issues, to consider the question of whether or not Bank of America owed shareholders additional disclosure, in light of the November 12 forecast, to supplement the November 3 proxy solicitation.

November 20, 2008 -- Mayopoulos and the Wachtell attorneys advised Joe Price that the company did not need to make additional shareholder disclosures.
December 5, 2008 -- Bank of America shareholders ratified the merger.
December 17, 2008 -- Bank of America CEO Ken Lewis called then-Secretary of Treasury Hank Paulson, initiating a series of events that resulted in a U.S. Government rescue of the merger. During the final two weeks of December, Federal Reserve officials and staff pored over Bank of America and Merrill Lynch internal financial documents.
January 1, 2009 -- the merger deal closed.
January 16, 2009 -- Treasury Department announced a $20 billion cash infusion for the combined entity Bank of America-Merrill Lynch and an asset loss insurance plan worth $118 billion.
January 20, 2009 -- Merrill Lynch reported an actual Fourth Quarter '08 loss of $21.5 billion.

Bank of America's legal duty

Publicly traded corporations are subject to antifraud and proxy rules under the Securities Act of 1933 and the Exchange Act of 1934.[1] Those rules prohibit, respectively, the omission of "a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading,"[2] and the making of "any solicitation... by means of a proxy statement...which at the time and in the light of the circumstances under which it is made...omits to state any material fact."[3] The Supreme Court has held, in the context of a proxy solicitation that: "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[4]

Investigation Findings

Over the course of this investigation, staff have reviewed over 400,000 pages of documents and interviewed the major players at Bank of America, Merrill Lynch and the law firm of Wachtell, Lipton, Rosen & Katz. We have found:

---

[1] Codified at 15 USC §77a et seq. and 15 USC §78a et seq.

[2] "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities, [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 17 CFR Section 240.10b-5(b).

[3] 17 CFR Sec. 240.14a-9.

[4] *TSC Industries, Inc. v.Northway, Inc.*, 426 U.S. 438, 449 (1976).

- Top officials at the Federal Reserve concluded that Bank of America knew or should have known in mid-November about the mounting losses at Merrill Lynch that ultimately led the Bank to appeal to the U.S. Government for a rescue.

- The top lawyer at the Fed speculated in email to Chairman Bernanke that Bank of America could be liable for securities law violations as a result of not disclosing that information to the Bank's shareholders.

- The November 12 forecast, created by Merrill Lynch and used by Bank of America's lawyers as a basis to determine if there was something shareholders should know before they approved the merger, omitted any forecast of how the most troublesome investments – collateralized debt obligations, subprime mortgage backed securities, credit default swaps – would perform in the next two months, November and December.

- In an interview with subcommittee staff, the former Merrill CFO admitted that the November 12 forecast was not, in fact, a valid forecast.

- Bank of America recognized that the November 12 forecast was deficient on the most crucial aspect of the acquisition – the potential for huge losses at Merrill Lynch. In an interview with staff, Mr. Cotty conceded that the November 12 forecast was of "questionable validity."

- However Bank of America did not do any actual analysis to make up for the Merrill omissions. On the contrary, Bank of America pulled a number out of thin air on November 13, which was recorded on the forecast document as the "gut" feeling of Neil Cotty. Bank of America simply created an assumption that Merrill Lynch' illiquid assets would almost break even for November, thereby spreading October's bad results over two months.

- The attorneys at Bank of America and at Wachtell, Lipton did not question the financial information they were given, in spite of the glaring and obvious omission and the explicit reference to a "gut" feeling. They advised Bank of America not to make further disclosures to its shareholders in advance of the merger vote, based on a deficient forecast and a "gut" feeling.

- The November 12 forecast's omission of any projection for losses in CDOs and other illiquid investments, and the implication that Merrill Lynch would break even in those investments for the remainder of the quarter, was material to the advice Mayopoulos gave Bank of America.

- Bank of America's Ken Lewis, Joe Price and Neil Cotty and Merrill Lynch's John Thain further agreed to pull another number out of thin air to supplement Merrill's omission of CDO performance in their December 3 forecast as well. Mayopoulos was made familiar with the financial data contained in the December

3 revised forecast, and he decided there was still nothing to disclose to shareholders.

Possible Legal Violations

As a law enforcement matter, the Subcommittee's findings form the basis of three possible legal violations by Bank of America and its lawyers.

First, a violation of Section 11 of the 1933 Securities Act, which creates private civil liabilities for false registration statements. Here, the question is, did Ken Lewis, Joe Price, Tim Mayopoulous and the Wachtell, Lipton attorneys *reasonably* rely upon the Neil Cotty guesswork and the deficient Merrill Lynch forecast?

Second, a violation of Rule 14a-9 of the 1934 Exchange Act. Rule 14a-9 prohibits false or misleading proxy solicitations. Here the question is, were Lewis, Price, and Mayopoulos *negligent,* and were the attorneys at Wachtell, Lipton *reckless*, in relying upon Merrill Lynch's deficient forecast and Cotty's guesswork?

Third, a violation of Rule 10b-5 of the 1934 Act, which makes it unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." Here the question is, were Bank of America and their attorneys *reckless*, i.e., did their conduct constitute an extreme departure from, or disregard for ordinary care?

Documents

Attached are documents gathered in our investigation. They include an annotated version of the November 12 forecast used by Timothy Mayopoulos, the original version of that forecast, handwritten notes by Wachtell, Lipton attorneys, as well as confidential emails and analyses prepared by staff at the Federal Reserve.

November 12 Forecast with Subcommittee notation

October's one month actual loss is nearly as large as loss for entire Third Quarter and is half Fourth Quarter 2007

Merrill Lynch omitted projection for November and December losses in CDOs and illiquid assets

Merrill Lynch & Co.
4Q'08 Forecast

Revenue ex Marks/FVA/One-Time	4Q07	3Q08	Oct Act (29 days)	Nov MTD (7 days)	QTD Estimate	BTG	4Q08F	B/(W) 3Q08	B/(W) 4Q07
FICC	554	623	(1,389)	160	(1,230)	249	(980)	(25[illegible].0%)	(214.8%)
Equity	1,653	1,363	1,027	53	1,095	555	1,650	20.6%	(0.2%)
IBK	1,050	571	102	41	143	509	652	14.1%	(39.6%)
GPID	295	(215)	(290)	(120)	(410)	(134)	(600)	(90.5%)	(301.6%)
GMI Other	(180)	136	67	(8)	53	(118)	(60)	(144.1%)	66.7%
GMI	3,764	2,309	(479)	130	(349)	1,011	662	(72.2%)	(82.1%)
GPC	3,414	2,922	1,094	329	1,423	1,574	2,997	2.2%	(12.2%)
GIM	151	86	(15)	15	(3)	49	46	(47.5%)	(69.[illegible]%)
GWM	3,564	3,021	1,076	344	1,421	1,622	3,043	0.7%	(14.6%)
Corporate	(72)	237	532	(13)	519	(644)	(125)	(142.[illegible]%)	(73.2%)
ML&Co ex Marks/FVA/One-Time	7,196	5,697	1,130	461	1,590	1,989	3,580	(37.2%)	(50.3%)
Significant Items (Non-Marks)	-	2,133	(2,619)	-	(2,619)	-	(2,619)		
Total Marks	(16,718)	(10,655)	(2,720)	-	(2,720)	-	(2,720)		
FVAs	1,381	2,842	(1,078)	(8)	(1,085)	-	(1,085)		
Total Marks/Significant Items	(15,337)	(5,681)	(6,417)	(8)	(6,424)	-	(6,424)		
Total Revenue	(8,192)	16	(5,287)	453	(4,834)	1,989	(2,844)	NM	65.3%
Comp	3,021	2,725	1,051	310	1,361	1,772	2,823	(3.6%)	6.6%
Non Comp	2,335	1,819	612	243	860	1,599	2,211	(21.6%)	5.3%
VICP	1,319	758	495	122	617	477	972	(28.2%)	26.2%
Total Expenses ex One-Time	6,675	5,302	2,158	680	2,838	3,849	6,006	(13.3%)	10.0%
Restructuring	-	40	(1)		(1)	1	-		
Temasek	-	2,500	-		-	-	-		
PTE	(14,926)	(8,251)	(7,536)	(227)	(7,763)	(1,859)	(8,942)	(8.4%)	40.1%
Taxes	(4,629)	(3,132)	(3,030)	(90)	(3,090)	(559)	[illegible]	13.7%	(23.0%)
ML Operating ATE	(10,297)	(5,119)	(4,536)	(137)	(4,673)	(1,300)	(5,383)	(6.2%)	47.7%
All In Results:									
EPS	$ (12.57)	$ (5.56)					$ (3.46)	$ 2.10	$ 9.11
Pre-Tax Margin	NM	NM					NM	NM	NM
Tax Rate	31.0%	38.0%	39.8%				39.8%	(1.8) pts	(9.51) pts
Ex Marks/FVA/One-Time Results									
Revenue	7,196	5,697	1,130			1,989	3,590	-37%	-50%
PTE	521	396	(1,028)			(1,859)	(2,420)	-714%	-566%
ATE	302	274	(714)			(1,290)	(1,634)	-714%	-569%
EPS	$ 0.23	$ 0.15					$ (1.97)	$ (2.12)	$ (2.26)
Average Common Equity	31,541	27,683							
Common Equity	27,549	29,750							
Preferred Stock	4,383	8,605							
Trust Preferred Securities	4,725	4,773							
Equity Capital	36,657	43,128							
Total Assets	1,020,050	875,780	862,100 est	864,193 est			TBD		
Adjusted Assets	647,345	572,395	574,900 est	561,143 est			TBD		

Page 1

4Q Forecast for CDOs and other exotic investments only reflects actual October losses, assuming a zero value for omitted projection for two-thirds of the Quarter: All of November and December

4Q Projected Company Loss omits any projection of CDO losses in November and December

Adjustment made by Bank of America adds $2 Billion in projected losses to the omitted projection in Merrill document. Fully half of the adjustment is based solely on the "gut" feeling of BofA's CAO, rather than any actual analysis of Merrill holdings

Bank of America top management and attorneys used this number in making shareholder disclosure decision.

(10,942)

-675 Alt-A from OCI to P&L
-1000 neil gut
-300 structured note fva (oct reversed 900 m)

November 12 Forecast-- Tim Mayopoulos copy

Merrill Lynch & Co.
4Q'08 Forecast

Revenue ex Marks/FVA/One-Time	4Q07	3Q08	Oct Act (25 days)	Nov MTD (7 days)	QTD Estimate	ETD	4Q08F	B/(W) 3Q08	B/(W) 4Q07
FICC	854	628	(1,369)	100	(1,230)	249	(980)	(256.0%)	(214.0%)
Equity	1,653	1,268	1,037	50	1,075	555	1,650	20.0%	(0.2%)
IBK	1,080	571	107	41	143	500	652	14.1%	(39.6%)
GMD	228	(315)	(242)	(120)	(416)	(104)	(600)	(90.5%)	(301.0%)
GMI Other	(180)	125	67	(8)	65	(115)	(92)	(144.1%)	68.7%
GMI	3,704	7,380	(470)	130	(349)	1,011	562	(72.3%)	(82.1%)
GPC	3,414	2,939	1,694	229	1,423	1,474	2,997	2.2%	(12.2%)
GIM	151	82	(12)	18	(2)	48	69	(47.5%)	(53.4%)
GWM	3,564	3,021	1,073	246	1,421	1,622	3,043	0.7%	(14.6%)
Corporate	(72)	287	592	(13)	519	(644)	(125)	(143.5%)	(73.2%)
ML&Co ex Marks/FVA/One-Time	7,196	2,607	1,130	261	1,699	1,089	3,560	(27.2%)	(50.3%)
Significant Items (Non-Marks)	-	2,133	(2,512)	-	(2,519)	-	(2,519)		
Total Marks	[illegible]	[illegible]	[illegible]		[illegible]		[illegible]		
FVA	1,331	2,042	(1,033)	(8)	(3,459)	-	1,022		
Total Marks/SI/FVA/One-Time Items	(15,387)	(6,031)	(6,417)	(8)	(5,474)	-	(6,424)		
Total Revenue	(8,192)	16	(6,287)	253	(4,034)	1,579	(2,834)	NM	66.3%
Comp	3,021	2,725	1,051	310	1,361	1,772	2,823	(3.6%)	6.6%
Non Comp	2,325	1,019	912	249	600	1,500	2,211	(21.5%)	5.3%
VICP	1,312	758	215	122	512	477	972	(70.2%)	23.2%
Total Expenses ex One-Time	6,676	4,502	2,153	609	2,636	3,048	6,006	(13.3%)	10.0%
FTAICS	54	425	92		92	-	97		
Restructuring	-	40	(1)		(1)	1	-		
Temasek	-	2,500	-		-	-	-		
PTE	(14,920)	(9,251)	(7,636)	(227)	(7,781)	(1,527)	(8,947)	(0.4%)	40.1%
Taxes	(4,623)	(3,132)	(3,080)	(90)	(3,030)	(550)	(3,590)	13.7%	(23.0%)
ML Operating ATE	(10,297)	(6,119)	(4,556)	(137)	(4,673)	(1,300)	(6,393)	(5.2%)	47.7%
All In Results:									
EPS	$ (12.57)	$ (5.50)					$ (2.45)	$ 2.10	$ 0.11
Pre-Tax Margin	NM	NM					NM	NM	NM
Tax Rate	31.0%	33.9%	33.6%				39.0%	(1.0) pts	(8.8) pts
Ex Marks/FVA/One-Time Results									
Revenue	7,190	5,037	1,130			1,660	3,369	-37%	-53%
PTE	521	795	(1,020)			(1,053)	(2,426)	-714%	-565%
ATE	392	274	(714)			(1,230)	(1,581)	-714%	-503%
EPS	$ 0.28	$ 0.16					$ (1.97)	$ (2.12)	$ (2.25)

	4Q07	3Q08				
Average Common Equity	31,541	27,553				
Common Equity	27,640	29,759				
Preferred Stock	4,383	8,635				
Trust Preferred Securities	4,725	4,773				
Equity Capital	36,657	43,125				
Total Assets	1,020,050	875,780	697,100 est	664,150 est		TBD
Adjusted Assets	647,340	572,305	574,060 est	551,145 est		TBD

(10,942)

-675 All-A fees OCI to P&L
-1020 ml gut
-201 structured note fvo (est reversed 900m)

5B loss
w/ #B contingency

89

Wachtell Lipton attorney Nicholas Demmo relays substance of conversation with Tim Mayopoulos, November 12, 2008

November, so far, is flat

ML lost $7 B in October

do we have to get the # out?

11/12/08

Demmo

all had a terrible October

Nov., so far, is flat.

ML lost $7B in October!

do we have to get the # out?

Meeting notes of Wachtell Lipton attorneys Ed Herlihy and Nicholas Demmo, November 13, 2008, where Mayopoulos' comments mentioned

11/13/08

Herlihy, Demmo, Shapiro, Wasserman

Q1 - 2 B loss
Q2 - 4.6 B loss
Q3 - 5.1 B loss
Q4 continues est. - .06 positive

Tim Mayopoulos —
assume Nov. better — worry about not discl.?

Tim Mayopoulos--
assume November
better -- worry about not
disclosing?

~~Herlihy~~ Stein

11/13/08

Nationsbank - BofA
stock for stock merger
ratio
subject of proxy statement mailed in 7/98
for vote to take place 9/24/98

8/98 - markets failing —
LTCM collapse

Q. arose -
BofA b/c of DE Shaw relat.
confronted issue of very
large write off for
loan to DE Shaw
1 B loan = DE Shaw's equity

Meeting notes of Tim Mayopoulos, Theresa Brenner and Wachtell Lipton attorneys, Ed Herlihy and Nicholas Demmo, November 13, 2008

Tim Mayopoulos, Ed, Nick 11/13/08
Teresa B.

Tim – more info
consensus ML = .06
prob. be [illegible] in trend
if just BofA side –
given ML's # – rec. both co report week or so before
our results not fabulous

Ed – because trend died?
what would we hear about Nov.

Tim – how much detail?

Ed – not much – like [illegible]

Tim – if ML break even for Nov. – $7B loss for 2 mos

Tim -- if ML breaks even for Nov. -- $7 B loss for 2 months

Nick – refer to past trend of losses? + say not dented!

TB – not speaking @ Goldman conf.
expect it to be no better than – might be worse

Tim – all agree must be some discl.
Ed – yes but [illegible]
Tim – [illegible]

November 12 Forecast cover sheet with Joe Price's notes from November 20, 2008 meeting with attorneys on shareholder disclosure question

"--Concluded [per] Tim [Mayopoulos] and Ed [Herlihy] that no pre meeting disclosures necessary"

— [illegible] - hedging [illegible]
[illegible] in value [illegible] hedge -
[illegible] unhedged losses - [illegible]
[illegible]
[illegible]
[illegible] losses. ([illegible])

— Concluded = Tim + Ed that no pre meeting disclosures necessary

— 700 '07 (less risk)
— 1100 '08 ([illegible] back to normal rules)

Merrill Lynch & Co

2008 4Q & FY Forecast

November 12, 2008

— DTA haircut -> Q3 worse 6.9 to 9.1 haircut
-> Every incremental $ of DTA gets haircut
->

Email from a senior adviser at the Federal Reserve, December 12, 2008

From: Tim P Clark
To: [illegible]
Subject: Update on BAC_ML
Date: [illegible]

The following is a quick update and some preliminary views in advance of the call at 3:30 today.

We (FRB Richmond, FRB NY and Board staff) are continuing to gather needed info for full assessment of ML through Bank of America (BAC) management, though much of what is needed for a good preliminary assessment on ML is in our possession and being analyzed. We also had a pretty good sense already of conditions at BAC, which have also deteriorated recently as evidenced by their own projection for Q4 having gotten significantly worse in the past week or two, and we are currently working to update are views on BAC as a stand alone entity. As they themselves noted the other night at our meeting, even on a stand alone basis, the firm is very thinly capitalized in terms of tangible common equity (TCE) relative to assets and exposures.

- It is notable that a quick analysis of the TCE/ on stand-alone basis and as a combined enti decline in BAC's projected year-end 2008 star be driving as much of the decline in the comb losses at ML, even as they are portraying the issue here. This is largely the result of declin and the fact that most capital in the combined BAC.

The preliminary assessment on the ML loss numbers is be being overly aggressive in some of its larger markd say that with certainty and for all postions -- so the si may not be over-stating the problems at ML to a large 'kitchen sink' the losses in advance of the acquisition date. Details on the sources of the 'new' $4 billion of losses are being sought right now and that will be included in the analysis once we get a bit more clarity.

General consensus forming among many of us working on this is that given market performance over past several months and the clear signs in the data we have that the deterioration at ML has been observably under way over the entire quarter -- albeit picking up significant around mid-November and carrying into December -- Ken Lewis' claim that they were surprised by the rapid growth of the losses seems somewhat suspect. At a minimum it calls into question the adequacy of the due diligence process BAC has been doing in preparation for the takeover. [As an aside, BAC management told us they could not provide electronic versions of ML files, and one wonders how that is possible since they have been doing the due diligence for months and having e-files would have made that much simpler and more effective

clear signs in the data we have that the deterioration at ML has been observably under way over the entire quarter – albeit picking up the significant around mid-November

Ken Lewis' claim that they were surprised by the rapid growth of the Losses seems somewhat suspect

Restricted Federal Reserve Analysis of Bank of America & Merrill Lynch Merger, December 21, 2008

- MER's deterioration has been substantially worse than BAC's and all but ensures that the firm could not survive as a stand-alone entity without raising substantial new capital (and/or government support) that is unlikely to be available given the uncertainty about its prospects and further future losses.

- Management now projects Q4 after-tax losses of roughly $14 billion for MER, and approximately a $1.4 billion after-tax quarterly net loss for BAC, which for BAC represents more than four times management's projected losses from just two weeks ago. The losses at MER will erode over 50% of MER's tangible common equity.

While the extent of the market disruptions that have occurred since mid-September were not necessarily predictable, BAC management's contention that the severity of MER's losses only came to light in recent days is problematic and implies substantial deficiencies in the due diligence carried out in advance of and subsequent to the acquisition.

- In the merger proxy statement and investor presentations the firm explicitly asserts that it has an understanding of MER's business activities, financial condition and prospects as well as an understanding of the outlook for the firm based on prospective economic and market conditions.
- Staff at the Federal Reserve has been aware of the firm's potentially large losses stemming from exposures to financial guarantors, which is the single largest area of risk exposure and driver of recent losses that have been identified by management. **These were clearly shown in Merrill Lynch's internal risk management reports that BAC reviewed during their due diligence.**
    - The potential for losses from other risk exposures cited by management, including those coming from leveraged loans and trading in complex structured credit derivatives products ('correlation trading') should also have been reasonably well understood, particularly as BAC itself is also active in both these products.
    - Having done a quick analysis on the specific positions/exposures at MER that generated the largest losses for MER in Q4, FRS staff see no clear indication that they were driven by overly aggressive marking down of positions in advance of the acquisition. This general conclusion notwithstanding, some of the marks do appear somewhat conservative and the appropriateness of the timing of the impairment charge taken against goodwill is hard to assess. On the other hand, credit valuation adjustments against financial guarantors are not particularly aggressive relative to those staff has observed at other firms

The combined firm remains vulnerable to a continuing downturn.

BAC management's contention that the severity of MER's losses only came to light is problematic and implies substantial deficiencies in the diligence carried out in advance of and subsequent to the acquisition.

These were clearly shown in Merrill Lynch's internal risk management reports that BAC reviewed during their due diligence

Restricted Federal Reserve Analysis of Bank of America & Merrill Lynch Merger, December 21, 2008

- MER's deterioration has been substantially worse than BAC's and all but ensures that the firm could not survive as a
capital (and/or government sup
uncertainty about its prospects

- Management now projects Q4
approximately a $1.4 billion af
represents more than four time
ago. The losses at MER will c

**While the extent of the market d
were not necessarily predictable,
MER's losses only came to light
deficiencies in the due diligence ca
acquisition.**

- In the merger proxy stateme
asserts that it has an under
condition and prospects
based on prospective econo
- Staff at the Federal Reserve
stemming from exposures to financial guarantors, which is the single largest area of risk exposure and driver of recent losses that have been identified by management. These were clearly shown in Merrill Lynch's internal risk management reports that BAC reviewed during their due diligence.
    - The potential for losses from other risk exposures cited by management, including those coming from leveraged loans and trading in complex structured credit derivatives products ('correlation trading') should also have been reasonably well understood, particularly as BAC itself is also active in both these products.
    - Having done a quick analysis on the specific positions/exposures at MER that generated the largest losses for MER in Q4, FRS staff see no clear indication that they were driven by overly aggressive marking down of positions in advance of the acquisition. This general conclusion notwithstanding, some of the marks do appear somewhat conservative and the appropriateness of the timing of the impairment charge taken against goodwill is hard to assess. On the other hand, credit valuation adjustments against financial guarantors are not particularly aggressive relative to those staff has observed at other firms.

The potential for losses from other risk exposures cited by management, including those coming from leveraged loans and the trading in complex structured credit derivatives products ('correlation trading') should also have been reasonably well understood, particularly as BAC itself is also active in both these products.

Email from General Counsel to Chairman Bernanke on December 23, 2008

From: Scott Alvarez
To:
Subject: Re: Fw: BAC
Date: 12/23/2008 11:23 AM
Encrypted

I agree we and Treasury gave our views on what we thought the likely effects would be of not proceeding, but that's different than ordering Lewis to proceed. We didn't take the decision out of his hands or threaten punitive supervisory action if he didn't proceed. I want to avoid the Fed being the centerpiece of the litigation. Lewis needs to have every incentive to analyze the facts and document and justify his decision. If he thinks he can rely on us, he'll assert there was nothing he could do and he can be reckless--not the right incentive. Moreover, once we're in the litigation, all our documents become subject to discovery and, as you'll remember from Deborah's presentation, some of our analysis suggests that Lewis should have been aware of the problems at ML earlier (perhaps as early as mid-November) and not caught by surprise. That could cause other problems for him around the disclosures BA made for the shareholder vote. In any event, we can always decide at the time of litigation whether to help even if now we hold fast.

Scott

Lewis should have been aware of the problems at ML earlier (perhaps as early as mid-November) and not caught by surprise. That could cause other problems for him around the disclosures BA made for the shareholder vote.

Email from General Counsel to Chairman Bernanke, December 23, 2008

From:
To: Scott Alvarez
Subject: Re: Fw: BAC
Date: 12/23/2008 11:08 AM
Encrypted

Thanks, Scott. Just to be clear, though we did no
did indicate that we believed that going forward w
(safety and soundness) of his company. I think th
may be just academic, but anyway: What would b
advance of a litigation but if requested by the defe
that our analysis supported the safety and soundn
merger and that we communicated that to Lewis?

▼ Scott Alvarez address deleted

Scott Alvarez/address deleted

12/23/2008 10:18 AM

address deleted

cc

Subject Re: Fw: BAC

Mr. chairman,

Shareholder suits against management for decisions like this are
than successful. Courts will apply a "business judgment" rule th
management wide discretion to make reasonable business judgm
holds management liable for decisions that go bad. Witness Bea
different question that doesn't seem to be the one Lewis is focu
disclosure. Management may be exposed if it doesn't properly d
that is material to investors. There are also Sarbanes-Oxley req
management certify the accuarcy of various financial reports. Le
to comply with all those reporting and certification requirements
completing this deal. His potential liability here will be whether
reasonably should have known) the magnitude of the ML losses
disclosures to get the shareholder vote on the ML deal in early D
his lawyers were much involved in that set of disclosures and Lewis was clear to us
that he didn't hear about the increase in losses till recently.

All that said, I don't think it's necessary or appropriate for us to give Lewis a letter
along the lines he asked. First, we didn't order him to go forward--we simply
explained our views on what the market reaction would be and left the decision to
him. Second, making hard decisions is what he gets paid for and only he has the

A different question that doesn't seem to be the one Lewis is focused on is related to disclosure. Management may be exposed if it doesn't properly disclose information that is material to investors.

His potential liability here will be whether he knew (or reasonably should have known) the magnitude of the ML losses when BA made its disclosures to get the shareholder vote on the ML deal in early December.

[Whereupon, at 12:37 p.m., the committee and subcommittee were adjourned.]

[The prepared statement of Hon. Gerald E. Connolly follows:]

Opening Statement of Congressman Gerald E. Connolly

"Bank of America and Merrill Lynch: How Did a Private Deal Turn into a Federal Bailout, Part V"

Oversight and Government Reform Committee

December 11th, 2009

Chairman Towns, thank you for holding a hearing that serves the vital role of using the Bank of America debacle to illustrate systemic problems with our financial regulatory system. The Bush Administration bailed out Bank of America because a succession of Administrations and Congresses not only failed to regulate the financial sector, but actually repealed essential consumer and investor safeguards that had been in place since the Great Depression. It is no coincidence that the repeal of these protections helped precipitate the most severe crisis since the very Depression that was the impetus for creation of such regulations. Remarkably, many regulators presciently warned of the problems that would cause the financial sector's collapse in time to avert it, but were ignored by both the industry and its allies in the Administration and Congress.

FDIC Commissioner Bair was one of those voices of reason. As far back as 1993, as a member of the Commodities Futures Trading Commission, she dissented from a majority opinion to deregulate the Enron's energy contracts division. She confronted the same arguments that we heard during the inflation of the recent Wall Street housing bubble: that market participants are rational, sophisticated, and do not need regulation. At the time, she said, "If we are to rationalize exemptions from antifraud and other components of our regulatory scheme on the basis of the 'sophistication' of market users, we might as well close our doors tomorrow."

In the sixteen years before the financial crisis, multiple Congresses and Administrations did just that. Congress repealed the Glass-Steagall Act, which prevented consolidation of securities, banking, and insurance firms. A revered Chairman of the Federal Reserve Board ignored warnings, including from Ms. Bair, that a housing bubble threatened the integrity of both the investment firms that were securitizing mortgages and the economy generally. As a result of systematic deregulation and blind faith in market forces, and willful ignorance to the repeated warnings of observers such as Ms. Bair, who later was appointed FDIC Commissioner, the federal government allowed a small group of myopic Wall Street investors to wreck the American economy.

As a result, a wily CEO from Bank of America was able to call President Bush's Treasury Secretary and, while the Treasury Secretary was on his treadmill, convince him to give Bank of America $20 billion of taxpayers' money. As we have learned from a series of hearings and the testimony of former Bank of America employees, Ken Lewis knew that he was calling the federal government's bluff. The bluff worked, not because Secretary Paulson was gullible, but because he couldn't risk even the unlikely possibility that Mr. Lewis was telling the truth. Paulson couldn't take that risk because a decade and a half of ideologically-driven deregulation had left Bank of America too big to fail, and left American taxpayers prostrated before Wall Street.

There is a very clear lesson from the five hearings that this Committee has held on Bank of America: Financial markets will not regulate themselves. Short term profit maximization will trump long term profits for individual firms, and that short term maximization will not only harm those firms' investors but will also have potentially devastating ripple effects through the economy generally, just as we saw last winter. Therefore, we must apply the lessons from this particular bailout to current considerations of financial sector regulation, and impose sufficiently stringent standards that firms will no longer be too big to fail and will no longer have the capacity, through their recklessness, to endanger our economy as a whole.